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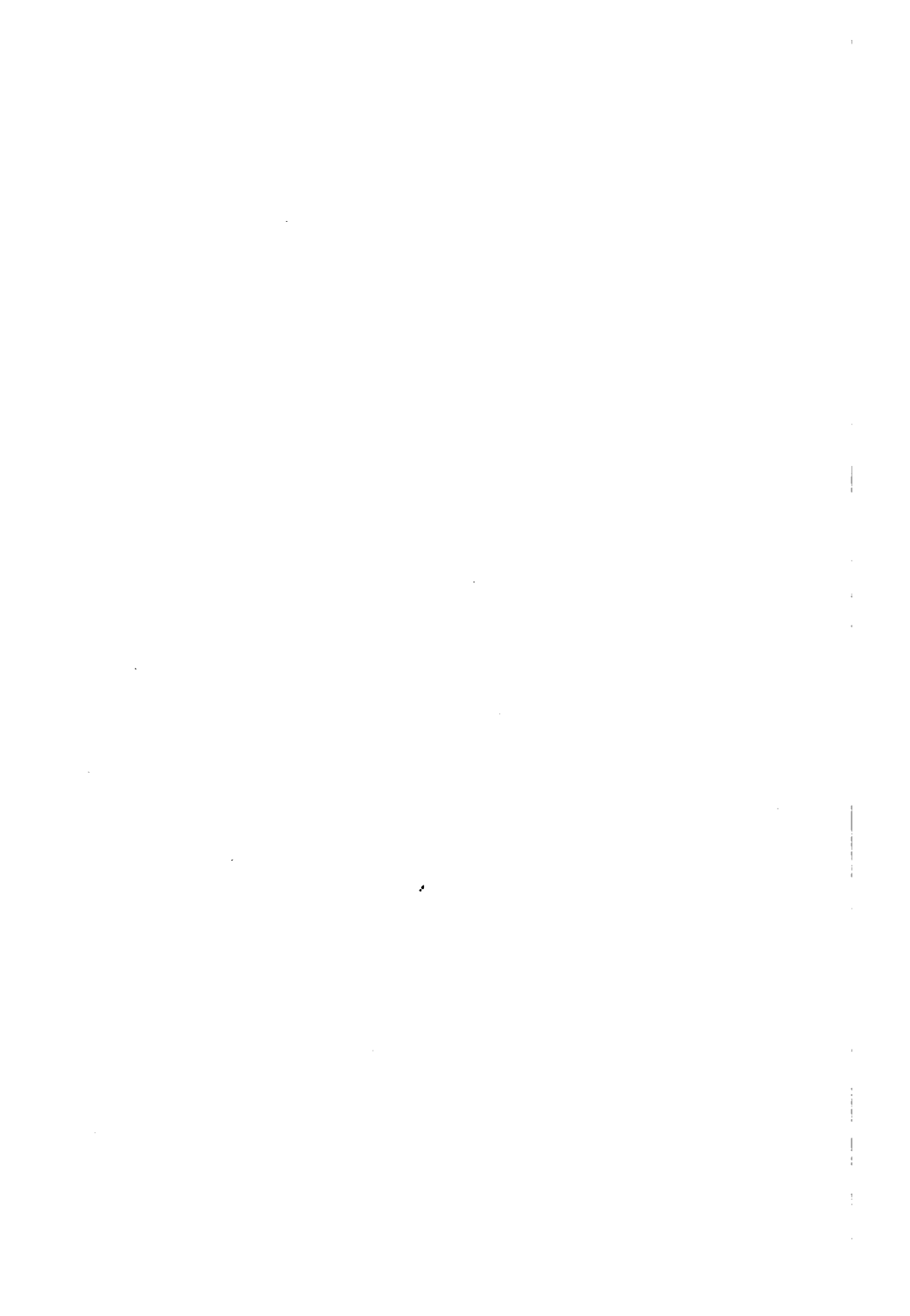


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CREDITS AND COLLECTIONS

BY

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PREFACE

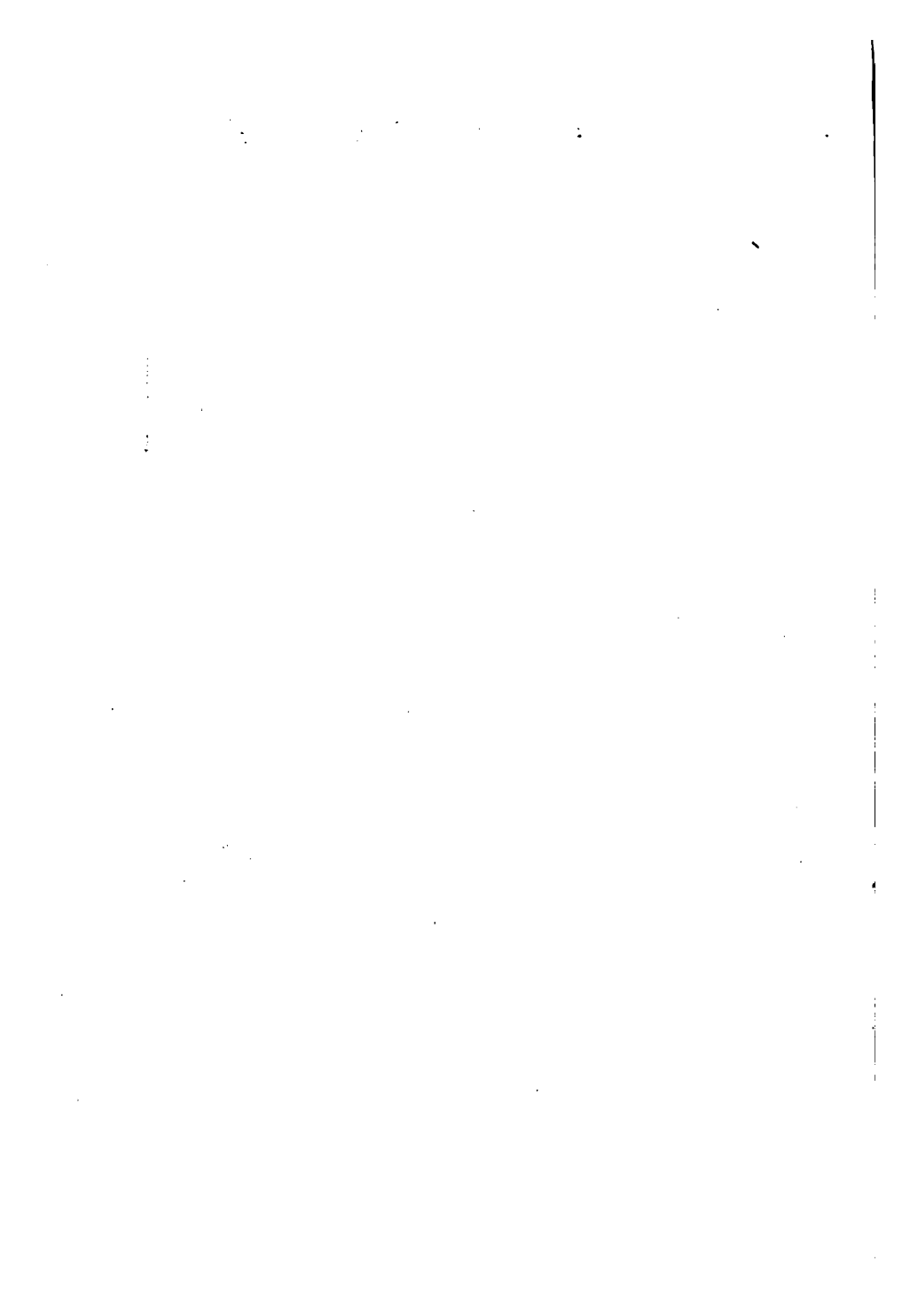
This book has been prepared primarily to meet the demands of classes in Credits and Collections conducted by Universities and other educational institutions in co-operation with local credit men's associations. The need for a book of this kind has been brought to the attention of the authors, not only by their experiences in their own classes, but also by the annual reports of the Educational Committee of the National Association of Credit Men.

The authors have attempted to set forth in proper detail the correct principles and practise of credit management, with special attention to mercantile credit. They have also discussed a number of practical credit problems, such as the analysis of financial statements, discounts, collections, adjustments, bankruptcy practise and credit insurance, with which the scientific credit grantor must be familiar.

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CHAPTER I

INTRODUCTION

In the work of the credit man can easily be found the germ of a profession. A profession is an occupation requiring special knowledge supplemented by constant search and research for new knowledge, wherein the practitioner regards the satisfaction of service to humanity as part compensation for his efforts. That this definition is appropriate for the so-called three professions of law, medicine and the ministry needs no demonstration. But we become confused when we call engineering or accounting or even business a profession. In fact many believe the antonym of profession is business and that it is contradictory to call business a profession. By a lofty mind almost any occupation can be exalted to the dignity of a profession, and on the other hand, even the traditional professions can be—and in isolated cases they have been—debased to the plane of self-serving business. The test, after all, is the attitude of the practitioner. Through ignorance, if not through avarice, some minds are incapable of assuming the professional attitude. They do not see the relation of their work to public welfare and, there-

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PREFACE

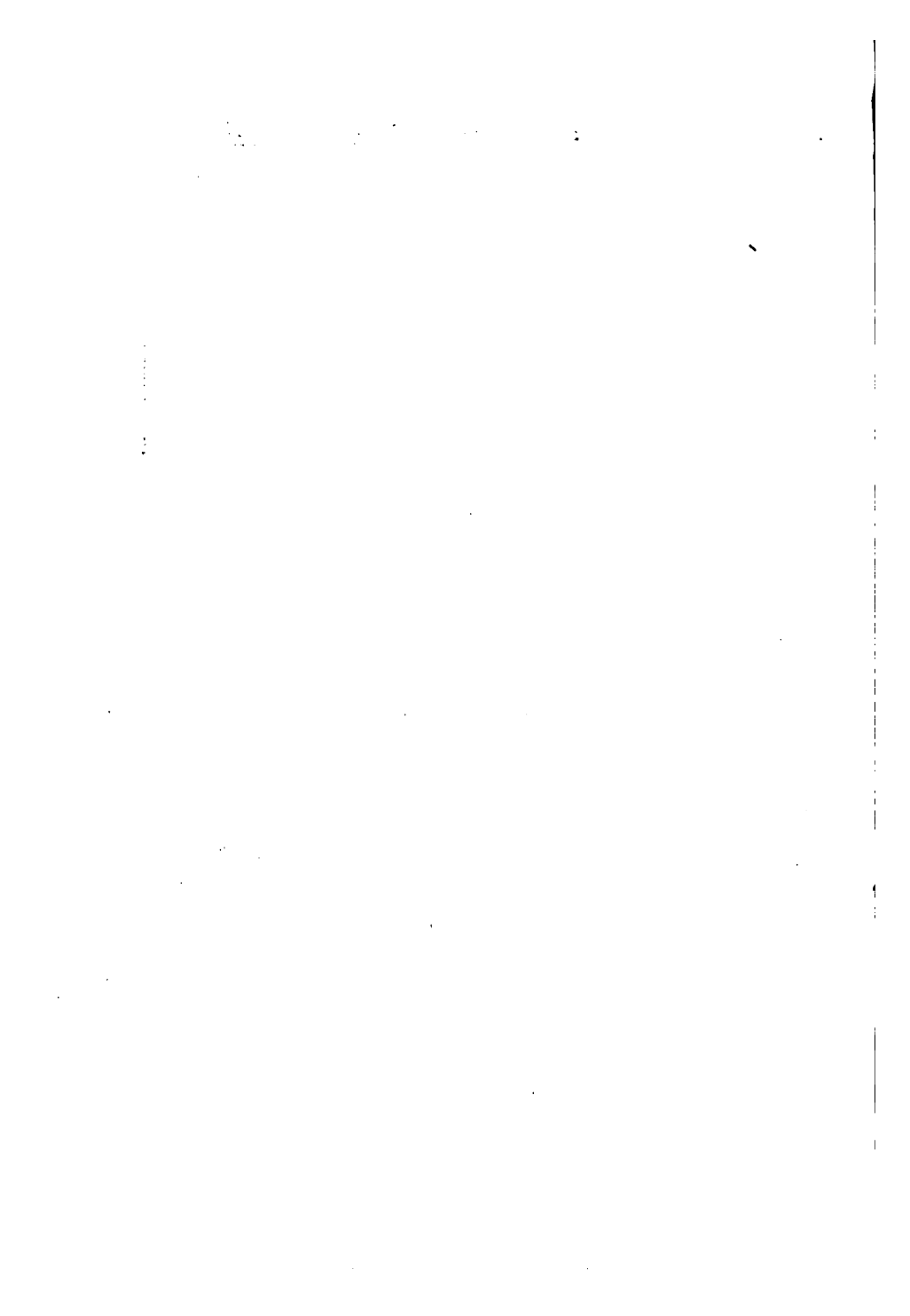
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conception of credit that leads to undue expansion of credit, speculative business, panics and consequent misery. It is easy to demonstrate that credit is not wealth. Three men, A, B and C, can give one another credit, which if wealth, would fill the coffers of the world. But while with this credit they could possibly get control of one another's property, soon this would be exhausted in supplying their wants, and then their credit would be as useless as a kettle with nothing to put in it. "No more wealth, no more capital, no more goods exist after credit is given than before. Nevertheless the use of credit does lead to an increase of wealth, for it brings the productive agents of a country into the possession of those men who are most competent to utilize them. Just as the railroad has rendered the rich prairies of Nebraska and Kansas available to the farmer, so does credit render available to the modern business man remote hoards of capital that would otherwise be idle. Indirectly, therefore, credit is an agent of production."¹

USES AND ADVANTAGES OF CREDIT

From the foregoing it must be obvious to the reader that credit cannot create something out of nothing. The mere extension of credit does not result in the creation of capital, but simply transfers the means of production from one person to another. True, this usually results in a transfer of capital from the hands of a lender or creditor unwilling or incompetent to use the capital himself, to a borrower or debtor more com-

¹ Johnson's *Money and Currency*, p. 37.

petent and willing to put the capital to work for him. Thus one who has capital which he is unable to use may deposit it with a banker and receive interest or compensation for the transfer of the capital. The banker in turn will lend the money so deposited to some trader or artisan, who can use the capital productively. Thus credit renders capital more productive.

Credit renders many other important and valuable services to the business man. These have been set forth with great clearness by Professor Conrad, and quoted by Professor Ely in his article, "German Co-operative Credit Unions," as follows:

"(1) Credit furnishes a more perfect and convenient means of payment in large sums and between distant places than the precious metals, saving time and labor. This is effected by means of notes, checks, and bills of exchange.

(2) Credit takes the place of corresponding amounts of gold and silver. This is a saving, as it enables us to employ the precious metals for other useful purposes.

(3) Capital is employed more productively. He who possesses capital, but is for any reason unable to make use of it, transfers it to another for a compensation, to the benefit of both, as well as that of the public economy. It is given, *caeteris paribus*, to him who is ready to pay the highest price for its use; that is, in general, to him who can employ it most productively.

(4) The laborers, artisans, and traders, although unprovided with means of their own, may by the use of credit obtain capital to assist them in their labors, and that without sacrificing their independence. This point is to be particularly borne in mind as of especial

weight in judging the credit unions. Credit is thus of importance in avoiding that separation of capital and labor which excites so much bad feeling, and which forebodes danger to modern civilization.

(5) Credit gathers together the smallest sums, which, by means of joint-stock companies and otherwise, are economically employed. Capital is concentrated, but its returns are disseminated among the people, politically a weighty point.

(6) The possibility of employing every sum, however minute, urges people on to saving.

(7) Credit binds together the interests of those having dealings with one another. Under a highly developed system of credit economy, it is the interest of each to show himself worthy of trust; this can be of advantage in the moral education of a people.

(8) It enables men to save for their old age, and make provision for their families in case of their death. Were there no such thing as credit, the best one could do would be to heap up, and then consume afterwards, the capital gathered together.

(9) Capital, when obtained under favorable circumstances, yields a larger return than the interest. Were it otherwise, borrowing, except in case of special need and distress, would cease. The prudent and skillful laborer who can command credit is thus enabled to obtain, besides his wages, a surplus from the use of the capital. Credit, *well used*, is, therefore, economically as productive as a favorable climate or a high education of a people."

THE PART THAT CREDIT PLAYS IN MODERN BUSINESS

In view of the great power of credit and the important benefits accruing from the use of credit, it is

not startling to learn that eighty-six per cent of the entire business of this country is done on credit. Dr. David Kinley, as a result of an investigation conducted for the National Monetary Commission in 1910, came to the conclusion that the percentage of checks and other credit paper used in retail payments was 60, and the percentage in the wholesale payments, 95. By weighing the proportion of deposits in banks for these two classes of dealers, Dr. Kinley decided that 86 would represent a fair average percentage of retail and wholesale business done with checks and other credit paper.

The various forms of credit paper and instrumentalities through which these credit transactions are carried on, are considered in the next chapter.

WHAT DETERMINES THE AMOUNT OF CREDIT USED?

To those who have read the foregoing paragraphs carefully it must be apparent that the extent to which credit is used depends upon two factors: (1) the need for a medium of exchange, and (2) the certainty of being able to realize on the obligation of the debtor. A multitude of forces vary the need for a medium of exchange, but in a general way the second factor may be said to rest on confidence.

It is not our purpose to analyze confidence at this point, but in order to understand what determines the amount of credit used it is necessary to indicate here that there is an objective and a subjective confidence that enters into the question of credit giving and credit use. A South American firm, for instance, may be

worthy of confidence—objectively the confidence or to be more accurate, the basis of confidence is present—but there may not be available means for the North American business house to get hold of the facts upon which it can establish confidence in its own mind—i. e., there is no subjective confidence. Generally then, we may say that credit will be used to a larger extent in those countries that have well developed facilities for collecting and transmitting credit information than in countries with poor facilities for collection and transmission of such information.

The importance of proper facilities for getting credit information will be dwelt on in a later chapter, but it is well to indicate at this point that the more certain the means of gathering credit information the more universal will be the use of credit. This is so by reason of the fact, that the general publication of reliable information will both stimulate objective confidence by making it necessary for the debtor to see to it that a report on his financial condition is favorable, and at the same time create subjective confidence by furnishing a basis of facts on which it can be founded.

One other classification of confidence is necessary in order fully to understand the factors that determine the volume of credit in use in any country or in use between countries. Confidence may be divided into moral confidence and legal confidence. The former is to a large extent based on the latter. Thus it may never be necessary to justify one's confidence in a debtor by resort to a court if the debtor knows that this agency exists to make him respect his obliga-

INTRODUCTION

II

tions. In general, therefore, credit is more abundantly used in countries where justice is certain, swift and inexpensive than in those countries where the law's delays and expensive litigation warn off the foreign business man.

CHAPTER II

FORMS OF CREDIT

Credit may be broadly divided into credit of general acceptability and credit of limited acceptability. The former, which is universally acceptable, is properly called money or currency. Federal Reserve notes, greenbacks, banknotes and silver certificates, all of which are mere promises to pay, belong to this group. Much has been written on this kind of credit and on the effect of an increase or decrease in the supply or demand for money upon prices, interest, and business in general—matters of the most vital significance to the successful business man. It is not our purpose to treat of these matters here. It is sufficient to note that credit instruments of unlimited acceptability serve in the country of issue as a substitute for money.

Credit of limited acceptability includes all other kinds of credit and credit instruments. It is this class with which we are mainly concerned. These credit obligations may be divided into book accounts, promissory notes, bonds, certificates of stock, checks, drafts, bills of exchange, acceptances and letters of credit.

No person can claim to understand the principles of credit unless he is thoroughly familiar with the meaning and uses of these various forms of credit.

BOOK ACCOUNTS

Probably the earliest and, certainly, the simplest kind of credit is the book credit. This kind of credit comes into existence, for example, when a consumer purchases an article from a storekeeper and has the goods "charged." No written memorandum or evidence of the transaction is given to the retailer by the consumer.

The retailer, however, makes an entry in his day book or ledger charging or debiting the customer, and that "book entry" is the only written evidence of the credit extended to the customer. It is quite obvious that this kind of credit has many disadvantages. In case of dispute between the retailer and his customer as to the amount of indebtedness, the book entry of the creditor as evidence of the debt would hardly be as satisfactory as would the promissory note or other written acknowledgment of the debtor. Again, if the merchant had the promissory note of his customer and desired to borrow money from his bank, he might more readily borrow the funds by discounting his customer's note. While it is true that his book accounts are personal property, and, as such, are saleable, nevertheless it must be remembered that lenders of funds are averse to accepting them as collateral.¹

On the other hand, retail book-credit has the im-

¹ There are bankers who specialize in the business of lending money on the pledge of open book accounts. How their business is conducted, and the advantages and disadvantages of pledging open accounts receivable will be the subject of later chapters.

portant advantages of stimulating sales, economizing the time required to make small payments, and obviating the burden, sometimes a dangerous one, of carrying large sums of money with which to make cash payments.

Like the retailer, the manufacturer sells to the wholesaler or jobber upon credit and often receives from him no written promise to pay. The only evidence here again is the entry made upon the books of the creditor, the manufacturer. In the same way the manufacturer or jobber sells to the retailer on open book credit. The manufacturer or wholesaler is probably in a better position than the retailer in that the former usually obtains a receipt in writing acknowledging the delivery of the goods. Moreover, certain bankers and financing companies are more inclined to lend money upon the pledge of the accounts receivable of the manufacturer. In other words, the open accounts receivable of a manufacturer or wholesaler are looked upon as a much better and more liquid asset than the accounts receivable of a retailer.

PROMISSORY NOTES

Our second class of credit instruments is promissory notes. A promissory note is a written promise to pay unconditionally a definite sum of money on demand or at some specified time in the future. A promissory note is given by a purchaser in payment for goods, or given by one person in exchange for money or the credit of another individual or bank.

Promissory notes, if payable to a particular person's

order or to bearer, are negotiable. Title to them may readily be transferred by endorsement and delivery. A purchaser of a promissory note takes it free from practically all the defences that would have been available against it had it been in the hands of the original payee. If the note is endorsed by the payee, he adds to it his personal obligation to pay the note in case the original promissor fails to pay. For this and other reasons, negotiable promissory notes make excellent security upon which banks may loan money.

The objects and advantages of requiring promissory notes from purchasers are numerous. First, the note is the best evidence of the debt. Second, the note definitely settles the amount due from the buyer to the seller. It practically closes all avenues of dispute as to quality or quantity of goods, date of payment and discounts.¹ Third, the note is an effective aid in compelling prompt payment of the account. As will be seen later, a debtor will frequently neglect to pay an open book account on the very day the account is due, but a debtor who wishes to maintain his credit standing will usually meet a note when due. Fourth, a promissory note is more readily transferable and salable than a book account. The holder of the note can endorse it over to his bank and thus raise funds on it.

Nevertheless, the use of "book account" credit is far more extensive than the use of promissory notes. In the retail trade, it is very unusual for a merchant to ask or obtain from his customers a promissory note. The customer pays his account by check or cash at the

¹ For a discussion of discounts see page 67, *post*.

end of each period. Even in dealings between the wholesaler and retailer, promissory notes are little used as compared with the extensive use of "book account" credit. The provisions of the recently enacted Federal Reserve Act¹ will, however, tend to encourage the use of promissory notes in business transactions.

BONDS

A third kind of credit instrument is the bond. A bond has been defined as "a written promise, under seal, to pay a specified sum of money, usually \$1,000, at a fixed time in the future, usually more than ten years after the promise is made, and is usually one of a series of similar bonds, all carrying interest at a fixed rate."²

Bonds have printed on their face, the security which is behind them. Mortgage bonds, for instance, are secured by a "so-called deed of trust, or mortgage, in which the corporation's property is mortgaged to the trustee for the benefit of the bondholders."² Debenture bonds have behind them no security other than the promise of the issuing corporation, and are really nothing more than long-term promissory notes under seal. Income bonds, on the other hand, have no "fixed interest," as the interest paid is entirely dependent upon the annual surplus of the issuing company. In this respect income bonds are very similar to shares of stock. The name of the bond frequently indicates its character, but quite as often the name is misleading

¹ See page 52, *post*.

² Gerstenberg: *Syllabus of Corporation Finance*, p. 15.

and recourse must be had to the contents of the bond and instrument securing the bond issue.

Bonds are usually issued by corporations to raise capital for the purchase of fixed assets or for permanent working capital. Notes, on the other hand, are seldom issued for these purposes, but are usually issued for temporary financing, to carry the business over the peak of the load or merely for temporary working capital.

Bonds are readily transferable by endorsement and delivery, and in most states are negotiable. They are often used by holders as collateral for procuring loans. A real estate mortgage, which is a conveyance of property for the purpose of securing a debt, although similar in many respects to a corporate mortgage bond, is not negotiable, but merely assignable.

SHARES OF STOCK

The ownership of a corporation consists of its capital stock, which is divided into shares, each share being a unit of ownership. The shares are evidenced by certificates. Thus, a certificate of stock is the mere evidence of part ownership in a corporation and is not a definite promise of the corporation to pay any fixed sum of money at any certain time in the future. The only promise the corporation makes to the stockholder is that, in case dividends are declared on the stock or in case the corporation is dissolved, the stockholder will receive his proportionate share. There is no distinct obligation ever to declare a dividend or ever to dissolve the corporation. The obliga-

tion of the corporation to its stockholders is not a liability, but rather an accountability. Nevertheless, we include stock among credit instruments, because the investor has given up a present valuable consideration in exchange for a future accountability, and further, because certificates of stock, like bonds, are negotiable and readily transferable by endorsement and delivery, and are frequently used as collateral for bank loans.

There are numerous classes of stock. Ordinary stock is known as common, and unusual stock, possessing a preference as to dividends, or assets, or being deprived of its voting power, is known as preferred. The essential characteristic of preferred stock is simply that it differs in some respect, whether advantageously or not, from the common stock. It is necessary to read carefully the face of the stock certificate or the certificate of incorporation to discover in what respect the stock is given "preference."

So-called corporate stock of a municipality, or government stock, is not stock at all, but really notes or bonds, which are promises to pay a definite sum of money at some time in the future. These instruments should properly be included among one of the two preceding groups.

CHECKS

So far, we have confined our discussion to credit instruments which are *promises to pay*. The most important and most generally used *order to pay* is the check. A check is a written order drawn upon a bank by a depositor, requesting the bank to pay on sight

a certain sum of money to the order of some person or corporation named on the face of the check. The check is so convenient that it has become the principal means of payment and the most used medium of exchange. As we have already seen money is used by a large majority of fairly well-to-do people only for payment of small items, and checks are used by these people almost exclusively for the settlement of larger amounts. The use of checks for payment by the consumer is rapidly increasing. Among the wholesale trade the check is used in practically all settlements.

A check is a negotiable instrument and is easily transferred. It may pass from hand to hand to pay many debts. Checks may be used in the payment of debts within a locality or in a distant city.

It will be seen that while a check is a mere order on the bank to pay, nevertheless, if the bank refuses to pay the check, because the maker has not sufficient funds in the bank or for other reasons, the check becomes the direct promise of the maker, and a holder may have recourse to him. The check, in case of non-payment by the bank, also becomes the direct obligation of the endorser.

When a depositor wishes to establish beyond a doubt that he has sufficient funds on deposit, and further that the bank will honor or pay the check, he will have the bank certify his check. The bank's cashier or teller stamps the word "certified" across the face of the check, and initials the certification. As soon as this is done the check becomes the bank's promise to pay. This, of course, adds greatly to the security of the

payee of the check. A certified check is used in payment when the drawer is not well enough known to the payee, or where cash is demanded. For example, where goods are shipped C. O. D., and the seller requires the purchaser to pay in cash, the seller will always accept a certified check, due to the confidence business men have in banks. Likewise in the closing of a contract for the sale of property, where cash is demanded as a condition precedent to the delivery of the deed, a certified check will be accepted by the vendor.

Another kind of check, frequently used in place of the certified check, is the cashier's check, which, as its name indicates, is an order on a bank signed by its cashier, payable to a person the depositor designates and charged to the depositor's account.

BANK DRAFTS

A bank draft is very similar to a check. It is an order of one bank on another bank to pay money to a person named on the draft. Banks keep deposits with banks in other cities so that they may draw upon them as occasion requires. Bank drafts are frequently used to make distant payments, for here there is a distinct advantage in that the drafts do not have to be returned to the place of the drawer bank before they are finally paid.

BILLS OF EXCHANGE

A bill of exchange is an instrument drawn by one person ordering a second person to pay a definite sum

or money to a third person on sight or at some definite future time. The first and third persons may be and frequently are the same; that is, one may draw to his own order upon another. A domestic bill of exchange is commonly known as a commercial draft. It usually originates in a sale of goods, the seller ordering the purchaser to pay either himself or another who will collect. The payee of the draft, if it is a demand draft, will cause it to be presented to the drawee, the person upon whom it is drawn, for payment. If the seller wishes to give the purchaser thirty or sixty days to pay, he will draw a time draft payable at thirty or sixty days after sight or at some definite time in the future. The payee will then immediately cause the draft to be presented to the drawee, and the drawee will accept the draft by writing across the face of the draft "accepted." When the drawee "accepts" the draft it becomes his promissory note and the drawer remains secondarily liable as endorser. The accepted draft, or as it is frequently called the "acceptance," may then be sold to or discounted at a banking institution. Moreover, it possesses all of the other advantages of the promissory note.

Although drafts at present are little used in domestic transactions in the United States, they do play an important part in the collection of accounts. However, there are many factors at work urging upon merchants the advisability of using drafts in domestic transactions, and it is very probable that as a result of the recently enacted Federal Reserve Act, drafts or "acceptances" will play a more important part in the settlement of accounts.

Bills of exchange or drafts are extensively utilized in foreign business transactions. It is a customary practice for the seller to draw upon the buyer, attach to the draft the bill of lading and other instruments evidencing the shipment, and sell or discount the draft at his bank. The local bank will then send the draft, with the instruments attached, to its correspondent bank in the country of the purchaser. The latter bank immediately presents the draft for collection, if a sight draft, or for acceptance, if a time draft, and collects the draft when due. The time draft, after it has been accepted, may be sold from one person to another until due. Because of the nature of the transaction that gives rise to a bill of exchange, it is considered a comparatively safe instrument for investment.

MONEY ORDERS

The postal money order and express money order are very similar to a bank draft, and are used to facilitate the transfer of funds. Like the bank draft, they possess the advantage of not having to be returned to the locality of the person making payment before they are finally paid.

LETTERS OF CREDIT

The traveler's letter of credit, which is intended primarily for the convenience of travelers, is a request from a banker or firm to some other banks or firms to advance money to the person named on the face of the instrument. One who purchases such a

letter of credit has the right to draw from time to time upon the issuing bank or firm up to the amount stated in the letter.

These drafts are presented to, and paid by, the foreign correspondents and branches of the issuing bank. The correspondents are repaid by the issuing bank.

SPECIMEN OF TRAVELER'S LETTER OF CREDIT ¹

GUARANTY TRUST COMPANY OF NEW
YORK

Circular Letter of Credit

No. 0000

\$2500. U. S.
New York, March 30th, 1916.

Gentlemen:

We beg to introduce to you, and to commend to your courtesies *Mr. Tom Jones*, in whose favor we have opened a credit of *Two thousand and five hundred Dollars*, Dollars U. S. Currency, and whose drafts to that extent at sight upon the

GUARANTY TRUST COMPANY OF NEW
YORK

140 Broadway

we engage shall meet with due honor if negotiated prior to January 1st, 1917.

¹ The specimen letters of credit and explanation given herewith have been taken from *How Business with Foreign Countries Is Financed*, a booklet prepared by the Guaranty Trust Company of New York.

The amount of each payment must be endorsed on this letter; and your negotiation of the drafts will be considered a guarantee that the requisite endorsements have been made.

You will please observe that all such drafts be marked as "Drawn against the Guaranty Trust Company of New York, Letter of Credit No. 0000."

This letter must be attached to the last draft drawn.

We remain, Dear Sirs,

Yours faithfully,

.....
Vice-President.

.....
Secretary.

Signature of
Tom Jones

.....
.....
To Messieurs Our Correspondents.

Traveler's Letter of Credit
(Back)

Showing how, where and what amounts beneficiary
has collected

SPECIFICATION
OF ALL PAYMENTS MADE UNDER THIS
LETTER OF CREDIT.

(Please endorse all payments in Dollars, U. S. currency, in which this credit is issued.)

25

[illegible]

THE COMMERCIAL LETTER OF CREDIT

A form of commercial letter of credit is used to finance importations of merchandise into the United States. A specimen of this letter follows:

Credit No.....

.....

GUARANTY TRUST COMPANY OF NEW
YORK

Foreign Department

New York, *March 30th, 1916.*

*Chino-Russian Export Corporation,
Shanghai.*

Gentlemen:

We hereby authorize you to value on Guaranty Trust Company of New York, New York, for account of *American Import Company, New York*, up to an aggregate amount of *Ten thousand Dollars* available by your drafts at *Four months' sight* against shipment of *raw silk* to *New York*. Insurance & War risk effected in *New York*.

Bills of lading for such shipments must be made out to the order of the Guaranty Trust Company of New York, unless otherwise specified in this credit.

Consular invoice and one bill of lading must be sent by the bank or banker negotiating drafts direct to Guaranty Trust Company of New York, NEW YORK.

The remaining documents must accompany the drafts drawn on Guaranty Trust Company of New York, New York.

The amount of each draft, negotiated, together with date of negotiation, must be endorsed on back hereof.

We hereby agree with bona fide holders that all drafts drawn by virtue of this Credit and in accordance with the above stipulated terms shall meet with due honor upon presentation at the Office of Guaranty Trust Company of New York, New York, if drawn and negotiated prior to.....

GUARANTEE TRUST COMPANY OF NEW YORK.

.....
.....

N. B. Drafts drawn under this Credit must state that they are "drawn under Letter of Credit
No.
Dated....."

A copy of this letter is forwarded by the importer to the foreign shipper. When the foreign shipper has assembled his goods for shipment, he will present this letter of credit together with shipping documents and a draft, details of which have to be in accordance with the terms specified in the letter of credit, to his local banker. His local banker will readily negotiate the dollar face value of the documentary draft at the best possible rate of exchange, no matter whether the drafts are drawn at sight or at three, four or six months after sight. Of course, the longer the tenor of the bill of exchange, the larger the deduction for interest, etc., the burden of which falls on the foreign shipper.

The foreign banker, who negotiates the exporter's draft, then ships the draft and documents attached to its New York correspondent, instructing him to present the documentary draft to the New York bank, which issued the letter of credit. The correspondent does this and the New York issuing bank accepts the draft, if a time draft, or pays it, if a sight draft, and retains the shipping documents at the disposal of the importer.

The documents are usually surrendered to the importer in trust, in evidence of which the importer executes a trust receipt giving the banker a first lien on the imported goods until the importer has paid the banker in full on or before the maturity of the underlying accepted bill of exchange. Of course, if the importer has taken out a sight credit, he will be expected to reimburse the issuing banker on the day of presentation of approved documents. The rate of

commission which the American banker charges his client for this service, varies with the length of the financing period and other considerations.

It will be noticed that in the text of these dollar credits, the issuing American banker obligates himself to honor and pay bills of exchange drawn in terms of his credit. It follows, that neither the negotiating foreign banker nor the accepting American banker can refuse to negotiate or accept, as the case may be, if the surface conditions of the credit have been observed by the shipper. Consequently this form of a negotiable instrument should be furnished to foreign shippers of established reputation only.

Needless to state, the New York bank before issuing such a letter of credit must be satisfied as to the moral and financial responsibility of its customer, the importer, because the transaction involves the granting of credit secured by merchandise during time of shipment. This period may extend over several months and in the interval considerable fluctuations in the value of the merchandise may take place.

AGREEMENT TO BE SIGNED BY THE CUSTOMER OF THE BANK

The following agreement is signed by the American importer in order to safeguard the bank against possible depreciation in the value of the merchandise, and gives the bank the right to dispose of the merchandise, if the terms of the contract are not maintained.

New York,19...

To the

GUARANTY TRUST COMPANY OF NEW
YORK

Gentlemen:

Having received from you the Letter of Credit on account of which a true copy is on the other side ^I_{we} hereby agree to its terms, and in consideration thereof ^I_{we} agree with you to provide in New York, one day previous to the Maturity of the Bills drawn in virtue thereof, sufficient funds in cash, to meet the payment of the same with per cent commission, and ^I_{we} undertake to insure at my our expense, for your benefit, against risk of Fire or Sea, all property purchased or shipped pursuant to said Letter of Credit, in Companies satisfactory to you.

^I_{We} agree that the title to all property which shall be purchased or shipped under the said credit, the bills of lading thereof, the policies of insurance thereon and the whole of the proceeds thereof, shall be and remain in you until the payment of the bills referred to and of all sums that may be due or that may become due on said bills or otherwise, and until the payment of any and all other indebtedness and liability now existing or now or hereafter created or incurred by ^{me}_{us} to you on any and all other transactions now or hereafter had with you, with authority to take pos-

session of the same and to dispose thereof at your discretion for your reimbursement as aforesaid, at public or private sale, without demand or notice, and to charge all expenses, including commission for sale and guarantee.

Should the market value of said merchandise in New York, either before or after its arrival, fall so that the net proceeds thereof (all expenses, freight, duties, etc., being deducted) would be insufficient to cover your advances thereagainst with commission and interest, ^I further agree to give you on demand ^{we} any further security you may require, and in default thereof you shall be entitled to sell said merchandise forthwith, or to sell "to arrive," irrespective of the maturity of the acceptances under this Credit, ^I ^{we} being held responsible to you for any deficit, which ^I bind and oblige ^{myself} ^{we} ourselves to pay you in cash on demand.

In case ^I ^{we} should hereafter desire to have this credit confirmed, altered or extended by cable (which will be at ^{my} ^{our} expense and risk), ^I ^{we} hereby agree to hold you harmless and free from responsibility from errors in cabling, whether on the part of yourselves or your Agents, here or elsewhere, or on the part of the cable companies.

This obligation is to continue in force, and to be applicable to all transactions, notwithstanding any change in the composition of the firm or firms, parties to this contract or in the user of this credit, whether such change shall arise from the accession of one or

more new partners, or from the death or secession of any partner or partners.

It is understood and agreed that if the documents representing the property for which the said Credit has been issued are surrendered under a trust receipt, collateral security satisfactory to the Trust Company, such as stocks, bonds, warehouse receipts or other security, shall be given to the Trust Company, to be held until the terms of the credit have been fully satisfied and subject in every respect to the conditions of this agreement.

It is further understood and agreed in the event of any suspension, or failure, or assignment for the benefit of creditors on ^{my}_{our} part, or of the nonpayment at

maturity of any acceptance made by ^{me}_{us}, or of the non-fulfillment of any obligation under said credit or under any other credit issued by the Guaranty Trust Company of New York on ^{my}_{our} account, or of any

indebtedness or liability on ^{my}_{our} part to you, all obligations, acceptances, indebtedness and liabilities whatsoever shall thereupon, at your option then or thereafter exercised, without notice, mature and become due and payable.

It is understood and agreed that you shall not be held responsible for the correctness or validity of the documents representing shipment or shipments, nor for the description, quantities, quality or value of the merchandise declared therein.

(Signature)

.....

THE USE OF CREDIT INSTRUMENTS IN PAYMENT

It is appropriate at this point to consider how a debtor may effect the payment of a debt by the use of the credit instruments above mentioned.

Suppose that *X* has bought a bill of goods from *Y*. *X* may pay in one of several ways: (1) He may "pay cash" and this might be in bank notes, United States notes, gold certificates, etc. (2) He may give *Y* a check on his (*X*'s) bank. (3) He may draw and deliver a bill of exchange on *Z* payable to *Y* or *Y*'s order. In such a case *Z* was presumably a debtor to *X*. (4) He may give *Y* a promissory note. This will merely defer actual payment. (5) He may "accept" a bill of exchange which *Y* has drawn upon him. (6) He may transfer to *Y* some check or promissory note or bill of exchange which some other person (say, *V*) has drawn to *X*'s order or to bearer. (7) He may buy from his banker a banker's draft or cashier's check drawn (on some other banker) in favor of *Y*. *X* may make this purchase by check or otherwise.

If *X* is in New York and *Y* is in London the payment is likely to take place in one of the following ways: (a) *X* may buy from his banker a (banker's) bill of exchange drawn on some London bank. He will send this to *Y* who will collect from the London bank; (b) if *Z*, in London, owes *X*, *X* may draw a bill of exchange on *Z* in favor of *Y*. He will send this to *Y* who will collect from *Z*. (c) Some other person, *V*, in New York, may have a debtor, *W*, in London. *V* may draw on *W*, payable to *T* or to

bearer, and then the bill may be sold in the open market. *X* may buy this in the market, indorse it to the order of *Y*, send it to *Y* who will collect from *W*.¹

¹ Marshal, Wright, Field, *Materials for the Study of Elementary Economics*, page 500.

owners or by outside investors. This capital is permanently, or for a comparatively long time, invested in the business. Where one owns a business, his investment can hardly be construed as "credit." But where one advances money to a business, in exchange for the company's promise to repay at some distant future time, there is a giving of credit, and the creation of what is termed investment credit.

While the student and credit man should be familiar with the practice of banking, and the elements of investments, we do not purpose to go into a detailed discussion of these subjects, but merely to set forth certain principles for further study and to give the reader a sufficient insight to stimulate his desire for further reading along these lines.

INVESTMENT CREDIT

We have already stated that credit extended to a business for its fixed assets is investment credit. The working capital which a concern requires in its normal state of business activity should properly be coupled with the capital required for fixed assets. This capital will be required permanently from month to month. It is not the function of a bank to lend its funds permanently or for use as the normal working capital of a business, but, as will appear later, only to help a business carry the peak of the load in the seasons when the business is paying for its goods and waiting for its customers to pay.

FORMS OF INVESTMENT CREDIT

Investment credit is represented by real estate mortgages, corporate bonds, long term notes, or other promises of individuals, firms or corporations, to pay money at some distant future time, and by stock in corporations, shares in joint stock companies, or other evidences of a right to a participation in the profits, and, in case of dissolution, in the assets of the issuing company. The bonds or long term notes may or may not be secured by a lien on some particular property or the entire property of the company.

SOURCES OF INVESTMENT CREDIT

The reader ought to have some idea of the numerous sources of investment credit. The individual who has saved some surplus funds, does not wish to assume the risk of destruction or loss by fire or theft, to which hoarded funds are subject. Moreover, one who saves or has surplus funds wishes to derive the greatest benefits from his savings or funds. If these funds have been laid aside for some future protection or reserve, the owner of them realizes the necessity of resorting to their earning power and not to the principal for present or current purposes. Idle funds produce no income, and so these persons, firms and corporations which have accumulated surplus funds all wish to put these surplus funds to work for them. These investors are constantly seeking to place their funds where they will return a fair *income* and where they will not be subject to great *risk*. At the same

time, these investors ordinarily desire to rid themselves of the burden of actively managing their funds.

In addition to the group of investors above mentioned, there is another class of individuals who have surplus funds to put to work, but who are anxious to make very large profits. They, of course, must be, and are willing to take a commensurately greater risk. And so we find that, in any investment, the risk usually varies directly with the income, and for every degree of variance, there is a demand by different persons or firms which have funds. Many business houses forego some income on part of their funds, by keeping a certain amount of money on deposit at commercial banks subject to check. These houses are compensated to some extent by the convenience of being enabled to draw checks against their accounts. Of course, due to competition, commercial banks are often willing to pay a small interest on these funds.

The above constitute all the *primary* sources of investment credit. All other sources, to which a business may look for investment credit, are secondary sources. These sources may be divided into two groups, banking institutions and trustees. The former would include banks and banking houses, which raise funds for some definite investment purpose. Trustees would include all institutions and individuals who invest funds not for themselves but in trust for others. The simplest example of investment by trustees is where funds are left by a deceased person to be invested by the trustee of the estate for the benefit of the kin of the deceased. In like manner the savings

banks, which are not conducted for profit, invest their deposits for the benefit of their depositors. Insurance companies, educational,¹ and charitable institutions belong in this same category.

It is very important for the management of a business to be thoroughly familiar with both the forms and sources of investment credit, for two distinct reasons: first, that the management may know where to apply for investment credit when permanent additions are required for its business; and second, that the management may wisely invest surplus funds which are not immediately required by the business.

BANKING CREDIT

If we examine the nature of a bank's work, the very close relation between banking credit and mercantile credit will be quite apparent. The so-called commercial bank, with which we are concerned, has two important primary functions; first, to receive deposits, and second, to make loans and discount business paper. When a bank receives deposits, it accepts the delicate trust of caring for those funds without subjecting the depositor to the dangers of loss. At the same

¹ Educational and other similar institutions are frequently primary sources of investment credit, in that they may invest their own funds as they choose. On the other hand, in giving funds for the establishment of an endowment or a similar purpose, the donor will frequently limit the investment of the funds to certain securities or a certain class of securities or otherwise. To this extent educational institutions are secondary sources.

time the bank keeps those funds employed as constantly as possible to earn enough to pay a reasonable dividend on the capital invested, besides the expenses of running the bank's business. To accomplish this dual purpose the bank must set up a very high credit standard for persons who apply for its credit in the way of loans or discounts. Moreover, a bank must keep itself in readiness to pay on demand, the checks or requests of its depositors for their funds.¹ However, experience has shown that only a small part of the deposit is likely to be requested from day to day. But, nevertheless, to meet even these demands, the bank must keep on hand a sufficient reserve of currency; the balance the bank can lend to producers and traders.

BANK LOANS

The profits of the bank depend upon its ability to keep its funds loaned out. The margin of profit a bank realizes is comparatively small, and for this reason a bank must be much more conservative in credit granting than are most mercantile houses which make a larger margin of profit. The bank must always be able to pay its obligations on the day they mature. A mercantile house may delay paying its

¹ The relation between the bank and its depositor is merely that of debtor and creditor. The bank, of course, does not keep the depositor's funds separate and distinct from the funds of other depositors. Each depositor is merely a creditor on the same footing as any other creditor, and no depositor has a lien on any special part of the bank's funds.

open book accounts for several days after their due date; likewise, mercantile houses may secure an extension of notes payable, or may secure a loan from its bank to meet maturing obligations. But with the bank it is different. Any attempt on the part of a bank to secure an extension from its creditors is a virtual confession of poor management and weakness, and is a forerunner of the bank's downfall. This means that the bank must, first, set up high standards for credit applicants, and, second, loan money only for short terms and on securities that are certain of quick realization. The bank cannot tie up its funds in long term loans, for to do so would mean that it might be unable to secure funds in times of necessity to pay its own maturing obligations. This merely bears out our previous statement that a merchant should not and cannot look to his bank for long term credit for permanent working capital or fixed assets, but only for short term loans. Moreover, when a merchant seeks a short term loan from his bank, he must be able to measure up to the high credit standards set up by the bank; he must be able to give the very best kind of security, either an unimpeachable financial statement of his own business or good bills receivable of his customers.

FORMS OF BANK LOANS

The simplest form of a bank loan is the discounting of a note receivable. Let us assume that Jones, a retailer, buys a five hundred dollar bill of goods from Smith, a wholesaler, on ninety days' time, and

gives Smith his note payable ninety days from date. Smith can then immediately present the note at his bank and have it discounted. The bank does not give Smith the face amount of the note less the discount in currency, but usually credits Smith's account with this amount. Smith is then in a position to purchase other goods, immediately pay for them, resell them to another retailer, and continually repeat the process. The retailer in turn will take up his note with the money received from the sale of the goods during the course of the ninety days.¹

This method of settling accounts by the giving of notes is little used to-day. The more advantageous plan for the retailer to follow is to borrow money from his bank on his own note, by presenting a statement of good financial condition to the bank. The retailer will then have funds with which to pay the wholesaler cash and thus obtain a much better discount or price² than under the system of note-giving. In this case the retailer will give the bank his note and the bank will credit him with the amount borrowed. Against this credit the retailer may draw checks with which to pay his accounts payable. It will be noticed that in both cases the bank loan takes the form of a credit to the depositor's account. No cash is given; the depositor's available funds are increased by aug-

¹ In this instance the reader must remember that Smith remains secondarily liable on the note, and in case Jones defaults in payment the bank will look to Smith.

² Firms who discount or buy for spot cash frequently enjoy merchandising advantages, such as opportunities to pick up job lots at special prices.

menting his checking account. The discounting of the depositor's notes, or the making of loans to the depositor is merely an exchange of the bank's credit for the business man's credit; the more universally acceptable for the less acceptable.¹

The notes given to the bank by the retailer, or merchant, signed by himself only, are known as "single name" paper. When such a note falls due the bank may look to only one person for its payment. The note described above, given by one merchant to another merchant and endorsed by the latter to the bank, is known as "double name" paper. When this note matures the bank may look to both merchants for payment. While single name paper is acceptable to a bank which is certain of the credit standing of the borrower, the bank is more secure in accepting double name paper for the above reason and because the bank is more certain that double name paper represents an actual sale of goods.

In this country, however, most of the strong whole-

¹ Technically speaking, when one deposits money in a bank, he *purchases* the bank's credit. That is to say, he buys, with funds, the privilege of drawing checks against the bank to the extent of those funds. When one secures a loan from a bank, he *borrow*s the bank's credit. He obtains the privilege of drawing checks up to a certain amount in return for his promise to repay the bank later. When one discounts another merchant's note at a bank he *exchanges* the other merchant's (plus his own) credit for the better credit of the bank. Of course, it might be said of the second case that there is an exchange of the merchant's own credit for the bank's credit.

sale houses do not require notes from their customers. They simply make a book entry of the debt. The strong wholesaler is able to discount his own note payable directly at the bank, or offer it for sale through note brokers.¹

Likewise, for reasons given above, the strong retailer prefers, when possible, to discount his own note payable at the bank and pay the wholesale house cash. In the past it has usually been only the weaker retailer who has given the wholesaler a note. The strong wholesaler in turn has not been inclined to discount any notes he has received from retailers. Thus it has come about in the United States that single-name paper has been more widely used than double-name paper. In the future, however, we may expect to see a change, for as a result of the recently enacted Federal Reserve Act, many banks are urging wholesale houses to obtain notes and "acceptances" from their customers and to discount these notes and "acceptances." If the wholesale houses follow this suggestion, as they undoubtedly will in the course of time, it is very probable that double name paper will be more prominent than single name paper.

ACCOMMODATION PAPER

Another "double name" paper, which is sometimes less acceptable to banks than either of those mentioned above, is the note bearing an accommodation endorsement. If we examine the circumstances which might give rise to accommodation paper the reason for its

¹ See page 48, *post*.

undesirability will be apparent. Suppose Jones, a retailer, has been granted his full limit of credit by the wholesalers from whom he makes his purchases. He finds need of additional stock to meet the prospective demands of a new season. He must pay cash for this stock. Where is he to obtain the cash? Probably heretofore he has never used his bank as a source for borrowing. He seeks out a friend, Smith, a man whose credit standing in the community is unquestioned, and asks Smith to endorse a note so that Jones may raise the necessary funds. Smith reluctantly and after much urging endorses the note and Jones secures the necessary funds by discounting it at the bank, where Smith is in high standing. The mere fact that Jones has been compelled to secure an accommodation indorsement indicates his weakness. If he should be unable to meet the note when due, the bank would call upon Smith, who, because he had endorsed the note merely as a matter of friendship for Jones, would put every obstacle in the way of collecting it.

Then, too, there are numerous cases where one comparatively weak concern, A, not being able to discount its own single name paper, obtains the accommodation indorsement of another weak concern, B. In return for this accommodation endorsement, A endorses B's paper. Thus, the paper of each concern is apparently strengthened by the endorsement of another concern. But actually the paper of each has become weakened by this exchange of endorsements! Suppose A fails, B will be called upon to pay the paper it has endorsed for A. And in all probability B, already in a weak condition, will not be able to stand the added

burden of this new obligation. B's failure is thus precipitated by A's failure, simply on account of the exchange of endorsements between A and B. Likewise, the failure of B would be followed by A's downfall. Thus, in the cases cited, accommodation endorsements have actually weakened the paper endorsed. For this reason, accommodation paper is sometimes not desirable. In any event, to determine the value of "accommodation" paper, it is necessary to examine the circumstances giving rise to the creation of the paper.

NOTES SECURED BY COLLATERAL

Sometimes a bank will require a borrower to pledge bonds or stock as collateral security for the payment of a note given by the borrower. This is merely an additional step to protect the bank against the borrower's possible inability to meet the note when due. Of course, the most desirable collateral for such a purpose is securities having a very wide market and ready sale, such as active bonds listed on the prominent stock exchanges. A form of collateral note in use is given below.

FRANKLIN TRUST COMPANY Collateral Note—Demand

\$2000.00

New York, March 15, 1917.

ON DEMAND, with interest at 4 per cent. per annum, we promise to pay to the order of the FRANKLIN TRUST COMPANY at its office, No. 46 Wall Street, in the Borough of Manhattan, City of New York, Two thousand and 00/100 Dollars, for value received, having deposited with said Trust Company as collateral security for the payment of this note and of all other liabilities of the undersigned to said Trust Company, due or to become due or which may

hereafter be contracted or existing, whether incurred directly or indirectly by the undersigned to the said Trust Company, including as well promissory notes, bills of exchange and other evidences of indebtedness in writing, made, endorsed or accepted by the undersigned and purchased or owned by said Trust Company, the following property, namely:

\$2,000 Chicago, Rock Island & Pacific Ry. Co. 1st & ref'g 4's 1934.

\$2,000 Denver & Rio Grande R. R. Co. 1st cons. mtge. 4's 1936.

The undersigned hereby agree to deposit with said Trust Company such additional satisfactory collateral security as the said Trust Company may from time to time demand, and also hereby give to the said Trust Company a lien for the amount of this note and of all the liabilities aforesaid upon all the property and securities at any time coming to or left in the possession of the said Trust Company by the undersigned, and also upon any balance of the deposit account of the undersigned with the said Trust Company.

On the non-performance of the foregoing agreement as to furnishing additional collateral, or upon the non-payment of this note or of any of the above mentioned liabilities, then and in either such case the said Trust Company is hereby authorized to sell, assign and deliver the whole or any part of said securities or any substitutes therefor or any additions thereto, or any other property coming into or left in possession of the said Trust Company by the undersigned for safe-keeping or otherwise, at any Brokers' Board in the City of New York, or at public or private sale at the option of the said Trust Company or of either of its officers without either advertisement or notice, which are hereby expressly waived. If such securities or property are sold at public sale, said Trust Company may itself purchase the whole or any part thereof free from all right of redemption or other right or claim on the part of the undersigned which are hereby waived and released. In case of any such sale the said Trust Company, after deducting all costs and expenses of every kind for collection, sale and delivery, may apply the residue of the proceeds of the sale or sales so made to pay one or more or all of the said liabilities to the said Trust Company, as the said Trust Company or either of its officers shall deem proper, whether then due or not due, making proper rebate for interest on liabilities not then due, returning the overplus, if any, to the undersigned, who agree to be and remain liable to the said Trust Company for any deficiency arising on such sale or sales. The undersigned do further authorize the said Trust Company at its option at any time to appropriate and apply to the payment of this note, or of any of the said liabilities, whether now

existing or hereafter contracted, any or all moneys now or hereafter in the hands of the said Trust Company on deposit or otherwise to the credit of or belonging to the undersigned, whether this note or the said liabilities are then due or not due. The undersigned, as well also the guarantors and endorsers of this note, if any, agree that in the event of the insolvency of or the appointment of an assignee for the benefit of creditors of, or of a receiver for the undersigned, or the appointment of such an assignee or receiver of or for any one or more of the makers of this note, if there are more than one, or of or for any one or more of the members of any firm who may make this note, or of or for any guarantor or endorser on this note, or in the event that a petition in bankruptcy shall be filed either by or against either of the persons above-mentioned, this note and all of the aforesaid liabilities shall, at the option of the said Trust Company or any of its officers, become immediately due without demand for payment thereof and without notice to the undersigned or any guarantor or endorser, which demand and notice are hereby expressly waived. Collateral to this note may be changed and increased, or reduced or surrendered at the option of said Trust Company or any of its officers without notice to any guarantor or endorser either on this note or any other liability of the maker hereof.

It is further agreed that the said Trust Company may transfer this note to any other person, firm or corporation, and that it may deliver the said collateral or any part thereof to the transferee of said note, who shall thereupon become vested with all the powers and rights above given to the said Trust Company in respect thereto, and the said Trust Company shall thereafter be forever relieved and discharged from any responsibility or liability in the matter.

William Walker & Co.

LOANS THROUGH NOTE BROKERS

The securing of loans through note brokers is a rather recent development resulting from changed conditions in credit granting. Before the Civil War, a merchant came to the city and bought goods. The seller shipped the goods and at the same time received a note from the buyer or drew a time bill on the buyer, which the buyer accepted. The seller put the

note or accepted bill in his safe or raised funds by discounting it at the bank.

The later system of giving cash discounts made it desirable for the buyer to take advantage of the discount by paying cash, *i.e.*, by paying within ten days. If the buyer paid by note this advantage could not be had. Furthermore, by giving a note the buyer would not have the same opportunity as under the open account to examine the goods and return whatever was unsatisfactory.

With this change, merchants began discounting their own notes at the bank. This custom increased to a very great degree and sometimes one or two banks in the locality of the merchant would find it impossible or undesirable to advance all of the funds required by the merchant. The problem of financing the notes of these merchants was met by so-called "note brokers." About 1870, houses grew up which devote themselves to the sale of merchants' promissory notes. Such houses are found in most large cities, including New York, Chicago, St. Louis, Kansas City, Omaha, Minneapolis, St. Paul and Boston. They take notes from the maker, and find a bank or banks, and in some instances private individuals, to whom they sell the paper at the market rate, which fluctuates from day to day. The broker may either buy the paper outright and then sell it, or he may first offer the paper for sale in accordance with the agreement previously entered into with the borrower. Where the name of the borrower is not very well known a bank may buy the paper on a ten-day option, which period will give sufficient time for an investigation of the credit of the

borrowers. The broker does not ordinarily endorse the notes, although he usually guarantees the signature of the borrower.

The broker frequently is a specialist in a certain class of paper, and a merchant usually confines himself to one broker. When, however, a merchant puts his paper in the hands of several brokers, it is usually a sign of weakness, and his paper will probably be thrown out by banks. At any rate, such a method would be looked upon with suspicion.

Notes are made as a rule in denominations of from \$2,500 to \$200,000 each, the \$2,500 notes being sold to country banks, and the larger ones in larger towns and cities. The unit common in the dry goods, grocery and jobbing trade is the \$10,000 note. The New England commission houses place notes in denominations ranging from \$2,500 to \$15,000.

THE ECONOMIC FUNCTION OF A NOTE BROKER

The reader may question the economic justification for the existence of the note broker. In anticipation of such a question we may say that both the merchant and the banker derive many advantages from the note broker's work. The merchant, even though his local bank has loaned to its full capacity, is able to raise sufficient cash through his notebroker, provided, of course, that the merchant is in good credit standing. Thus, the note broker saves the merchant time, worry, and sometimes embarrassment in obtaining loans. Moreover the merchant, by borrowing through the note broker from banks in different parts of the coun-

try, is frequently able to obtain cheaper rates of interest than could be obtained at the home banks. Then, there is some advantage to the merchant in having his paper in many hands. The chief among these is that he becomes known as a good credit risk and will have a wide range of people with money to lend at any time he enters into a large transaction.

The advantages to the bank may be summarized as follows: first, a bank may not be able to loan sufficient funds in its own community; the market is too narrow. Through the note broker, however, the market is extended to absorb all the bank's available funds. Second, the bank is frequently enabled to obtain better interest rates in other parts of the country than home conditions warrant. Third, the bank likes a certain amount of this kind of paper, because there is no obligation to renew it at maturity. A bank which loans to the merchant direct is practically obliged to support him by renewing his note if necessary. On the other hand, the transaction between the broker and the bank is a purely personal one, and if the bank refuses to buy the notes or renew them the merchant knows nothing about it, nor does he care just so the notes are sold.

The note broker, on his part, wants all the paper put out through him to be good, for if one of his clients defaults the broker's business may be seriously injured. Moreover, the broker is well equipped, because of his specialized interests, to pass judgment upon the quality of paper he handles, and he will see to it that the merchant does not over-extend. For these reasons the banker feels secure in accepting paper

recommended by the reputable note broker. Indeed it is seldom that such paper is not honored. Speaking from the viewpoint of the bank, one writer says, "It is just so much money that can be counted on, except in the most trying times, and even during the panic of 1907, paper of this kind was paid promptly, while other notes were renewed." Every large merchant should strive to establish such a credit, for it may stand him in good stead in times when he requires funds immediately.

FEDERAL RESERVE ACT

It is appropriate to point out briefly the features of the Federal Reserve Act that will affect the ability of the merchant to borrow funds or extend his credit. Under this Act, member banks, that is, National or State banks which are members of the Federal Reserve System, may rediscount notes, drafts, and bills of exchange at a Federal Reserve Bank by endorsing them. The Federal Reserve Board¹ is empowered to issue Federal Reserve Bank Notes to Federal Reserve Banks upon receiving a deposit of commercial paper from such banks. These Federal Reserve Notes are legal tender, and are redeemable in gold or lawful money at any Federal Reserve Bank, or at the United States Treasury. To the business man in good stand-

¹ The Federal Reserve Board consists of seven members, including the Secretary of the Treasury and the Comptroller of the Currency and five members appointed by the President. The Board exercises general supervision over reserve banks and has the right to regulate the activities of member banks.

ing this scheme means that, even in panicky times, he can obtain necessary funds from a member bank, for the member bank in turn may rediscount his paper at a Federal Reserve Bank and obtain from it the necessary currency.¹

¹ The provision of the Federal Reserve Act relating to this is section 13, which reads: "Upon the indorsement of any of its member banks, which shall be deemed a waiver of demand, notice and protest by such bank as to its own indorsement exclusively, any Federal Reserve Bank may discount notes, drafts, and bills of exchange *arising out of actual commercial transactions*; that is, notes, drafts, and bills of exchange issued or drawn for agricultural, industrial or commercial purposes, or the proceeds of which have been used, or are to be used, for such purposes—the Federal Reserve Board to have the right to determine or define the character of the paper thus eligible for discount, within the meaning of this Act. Nothing in this Act contained shall be construed to prohibit such notes, drafts and bills of exchange, secured by staple agricultural products, or other goods, wares, or merchandise from being eligible for such discount; but such definition shall not include notes, drafts, or bills covering merely investments or issued or drawn for the purpose of carrying or trading in stocks, bonds or other investment securities, except bonds and notes of the Government of the United States. Notes, drafts and bills admitted to discount under the terms of this paragraph must have a maturity at the time of discount of not more than ninety days, exclusive of days of grace; *provided*, That notes, drafts and bills drawn or issued for agricultural purposes or based on live stock and having a maturity not exceeding six months, exclusive of days of grace, may be discounted in an amount to be limited to a percentage of the assets of the Federal Reserve Bank to be ascertained and fixed by the Federal Reserve Board.

There is another provision in the Federal Reserve Act that should prove of great value both to banks and to business houses engaged in foreign trade. That is the provision permitting member banks to accept and rediscount bills or drafts based on the exportation or importation of goods, and maturing in not more than three months. Such an acceptance may arise, for example, where A in New York buys a bill of goods from B in London, on sixty days' time. A's credit standing is not well known to B in London, but is well known to A's bank in New York. A, therefore, arranges with his bank to "accept" for him a draft which B will draw against it. A in this case either has sufficient funds at his bank to pay the draft at maturity or promises to provide them at the necessary time. B draws against A's bank and discounts the draft at his own London bank. B's bank sends the draft to their New York correspondent, C bank, which in turn presents the draft to B's bank for acceptance. After B's bank has "accepted" the draft, it becomes the promissory note of B's bank and is readily saleable to any bank. This plan will greatly facilitate the building up of foreign credits, for the reason that the local banker is better acquainted with the credit standing of the debtor than is the creditor in a distant place.

New York State has passed a law giving State banks the privilege of accepting bills arising out of domestic as well as foreign transactions. The advantage here is that a banker in, let us say, Troy, New York, is in a better position to get an insight into the business and character of a merchant there, than

is a selling house in San Francisco. And for that reason the Troy banker is better able to pass judgment on the merchant's worth. Very probably, as soon as these advantages become well known and generally utilized, other states will enact laws similar to the one in New York.

Quite recently an amendment to the Federal Reserve Act was passed which gives member banks, in addition to the power to accept bills involved in the exportation or importation of merchandise, the privilege of accepting drafts and bills of exchange having not more than six months' sight to run, growing out of transactions involving *domestic* sales and shipments of goods, provided shipping documents conveying or securing title are attached at the time of acceptance. This is practically the same privilege possessed by New York State banks; and the amendment will allow Federal Reserve member banks to render effective aid in financing commercial transactions in this country and in enabling local merchants to widen their field of purchasing.

CHAPTER IV

CLASSES OF CREDIT AND CREDIT MACHINERY (*Continued*)

PERSONAL CREDIT

Personal credit is the credit a merchant extends to an individual or his family to enable them to obtain goods for their own use or consumption. In short, it is this kind of credit that is of primary interest to the credit man or owner of a retail business. Retail credit, however, is of the utmost importance to the jobber, the wholesaler, the manufacturer, the bank, and every one along the entire line of distribution and financing. The jobber extends credit to the retailer to give him time to realize on the merchandise purchased. The manufacturer for the same reason extends credit to the jobber, and so on down the line. Let us assume that a certain retailer is very careless in his credit granting and by reason thereof suffers severe losses and is unable to pay the jobber. It is easy to see that if several retailers buying of the one jobber did likewise this jobber's position would be perilous, and unless he were unusually strong it would not be long before he would "go to the wall." His failure, together with the failure of other jobbers, would mean ruin to some manufacturer, and so on through the

entire mercantile structure. Of course the poor retail credit conditions would have to be very extensive indeed to bring about such a collapse as we have pictured. This, however, was the condition in the South in the fall of 1914 immediately after the outbreak of the great European War. Due to the cotton situation, consumers had no funds with which to pay retailers. The retailers in turn were unable to pay the wholesalers. This caused embarrassment to a number of wholesalers. Even though the retail failures, resulting from poor credit granting, were not so extensive, nevertheless, the other merchants in the chain, that is the jobbers and manufacturers, would suffer some loss through non-payment by those retailers who failed or through decreased purchases by the retailers who remained in business. For if the retailer who suffers losses from improper credit granting is to continue in business, he must exact from the consumer who pays, higher prices to compensate him for the loss. This results in larger margins of profit for the retailers referred to, and consequent higher prices for the consumer, and a decrease in the quantity of merchandise sold. This decrease is accounted for by the elimination of purchases by the marginal consumer, who cannot afford to pay the higher prices.

Who, then, suffers by the retailer's improvident credit granting? First, of course, the retailer himself. Second, the honest consumer; he must pay higher prices. Third, the manufacturer, jobber, and other distributors; they suffer financial losses through retail failures.

It is unnecessary to dwell upon the extensive use of

retail credit or upon the stupendous losses, caused mainly by improper retail credit granting, to convince the retailer and other merchants of the importance of this subject and its relation to mercantile credit. The facts are well known and are sufficient in themselves.

REASONS FOR CARELESS RETAIL CREDIT GRANTING

That the retailer has been careless in credit granting is hardly controverted. And yet how few have investigated the causes! There are many reasons accounting for this neglect on the part of retailers in making a proper or a sufficient inquiry into the limit of credit to which the consumer is rightfully entitled. The first and foremost reason is the ignorance of many retailers of their costs of doing business. If retailers kept proper books from which they could ascertain the added expense of collections and credit losses, they would not be so desirous of extending their business by the granting of unwise credit. The second reason is the retailer's quite natural desire to outdo his competitor in *volume* of business, forgetting entirely about the *quality* of the business. The keeping of proper accounts would soon impress upon the merchant the foolhardiness of doing a large business built upon unsound credits. The third reason is the retailer's fear of driving away customers by asking them questions absolutely necessary to enable him to pass on the credit risk. This fear is not unfounded, for a great many consumers do have a false idea of the humiliation attendant upon such inquiry, and deeply resent the giving of any information that they consider "strictly

personal." Fourth, retailers are negligent in setting a definite date on which payment is expected. Thus, the retailers do not take advantage of the psychological effect of, first, naming a definite day to meet the salary requirements of the consumer, say, weekly on Mondays, or monthly on the first, on which payment is expected, and second, of getting the consumer into a habit of making payments at regular intervals, both of which so greatly help in collections. Fifth, there is lack of co-operation among retail credit grantors. The baker, the butcher, or the grocer seldom, if ever, in most communities call upon each other for information as to how Jones is paying, or to what extent he is owing. Such co-operation would prevent over-extension of credit to one individual. Again, when Mr. Newcomer arrives in a town, seldom do the retailers of this town attempt to find out his paying habits in his previous residence. Professional crooks could be thwarted by such co-operation. Lastly, retailers have not had sufficient facilities for obtaining credit information. Rating books and reports are published by retail credit bureaus ¹ in but few communities. These retail bureaus are still in an embryonic stage, but they are doing a great deal in dispensing information concerning the credit standing of consumers in the community.

How are these conditions to be remedied and how is the standard of retail credit granting to be raised? These questions are vital to every merchant who would further safeguard his own interests. Before we can

¹ A thorough discussion of the organization and workings of retail credit bureaus will be found on page 151, *post*.

attempt to discuss them it will be necessary to set forth certain principles governing the proper basis for retail credit granting.

THE PROPER BASIS FOR RETAIL CREDIT GRANTING

In the granting of retail credit, as in the granting of any credit, there are three factors controlling the limit of credit to be granted—character, capacity and capital. The consumer's character is all important. A man with character of the right kind will not attempt to purchase what he does not expect to be willing and able to pay for, at the proper time. Even should a man with character suddenly meet with reverses, and find himself temporarily unable to pay, he could be relied upon to pay as soon as possible under the circumstances. But the retailer should consider not only the character of the credit applicant, but also his capacity, his ability to pay for what he buys. One who purchases beyond his means, that is, beyond his income, or extravagantly and carelessly, should not be entitled to credit. On the other hand the wealth or capital of a person should not be given too great a consideration. While it is true that one who is slow and negligent in making payments and is wealthy can probably *eventually* be compelled to pay, the expense of collecting and the time required to make the collection would hardly warrant granting credit to such a person.

There are a number of methods by which to test these three factors in the credit risk. The best criterion is the past record of the credit applicant. How

has he met his obligations in the past here and elsewhere? How he has paid his debts at this establishment, the retailer can ascertain from his own books. This again illustrates the importance to the retailer of keeping proper books. How the consumer has paid his debts at the other retailers can only be determined by inquiry at the other shops or at a central credit information bureau. For this purpose there must be proper co-operation among the retailers. It is indeed important to find out the record of the consumer at other stores, for who can tell but that the consumer is compelled to deal at one store because he has destroyed his credit standing elsewhere. By this means, moreover, the retailer is able to find out the consumer's habit of paying, promptly or otherwise, and if the consumer changes that habit the retailer will immediately be put on his guard.

The retailer will do well to find out the employment of the consumer, when he is paid, and whether or not such employment is seasonal and, if possible, the income derived. With such information at hand the retailer knows when to expect payment and can help form a regular habit of paying. The writer realizes that a great many are reluctant to give information of what they consider "personal affairs," and that the retailer is compelled to resort to subtle means to secure the information. A great deal of educational work is necessary to make the good credit risk realize that he is paying for the defaults of the poorer credit risk and professional beat. As soon as this is sufficiently impressed upon all consumers, the one who intends and is able to pay his debts will no longer hesitate to

give this information, and others may be looked upon with suspicion.

Another important matter to consider is the personal habits of the consumer and his family. Do they practice due economy, or do they attempt to live beyond their means? Their inclinations in dress, pleasure and companions should likewise be kept in view when granting credit. In this connection the wisdom of the family's purchases should be taken into account and credit should not be extended if the purchaser is buying beyond his requirements.

Were the retailer to practice these suggestions he would suffer fewer credit losses, and the other merchants in the credit chain would all be helped. Yet, for reasons we have pointed out, the retailer has been inclined to be careless about his credit granting. The question arises then, how can the retail credit be raised to a proper standard? The answer is, simply by the proper education of the retailer and the consumer up to these standards. We have pointed out that wholesalers and manufacturers and other large merchants were the ones who had to suffer eventually as the result of poor retail credit granting, and yet but very few have either realized this or raised a hand to help lift retail credit out of its more or less chaotic condition. The most important thing the retailer must be taught is why and how to keep proper books of account. Fortunately, the National Association and various local associations of Credit Men are accomplishing a great deal along these lines. Furthermore, retail merchants and their credit men are learning the importance of co-operation and are practicing it in various

communities. In the future we may expect to see more scientific retail credit granting.

MERCANTILE CREDIT

Mercantile credit we have described as the credit one merchant obtains from another when goods are purchased on time for resale. Applying our earlier definition,¹ it is the power to secure goods for resale in exchange for a promise to pay at some specified future time. Transactions giving rise to mercantile credit are on a very much more extensive scale than are those transactions involving personal credit. The result is a more highly developed and sensitive system of credits.

The retailer requires credit when he makes a purchase so that he may have sufficient time to sell the goods to the consumer and enable him to repay the jobbers with the proceeds. The jobber, in turn, must be given time enough to collect from the retailer before the manufacturer can look for payment. The manufacturer obtains credit from the wholesaler or selling agent, who in turn looks for credit to the mills or first manufacturer. The grower or original producer is seldom in a position to extend credit to the mills, and so the mills must look almost exclusively to financial houses for any credit accommodations they require. A product does not necessarily pass through the hands of all the merchants described; some products do; others need only be handled by one or two of the middlemen.

¹ See page 4, *ante*.

The reader must avoid any impression that one merchant may look to the one who handles the goods earlier in the chain for all the capital or credit needed in the conduct of his business. As a matter of fact it is only to the extent of the original cost of the goods that a merchant obtains mercantile credit. Each merchant along the line contributes something to the goods. For example, in the case of cotton goods, the mills turn the raw cotton into cloth, the converter may dye it, the manufacturer makes up garments, the jobber prepares the garments for selling and shipment in sufficiently small quantities to the retailer. Each merchant requires capital to pay not only for the goods, but also for the cost of labor applied to the goods while they are in his hands. The labor and overhead costs must be financed out of the merchant's original capital or out of funds borrowed from banks or other financial institutions. The cost of the materials, however, may be financed by the credit obtained from the merchant from whom the purchases were made. But the mill or merchant who first purchases from the grower usually does not obtain credit from the grower, and therefore must be prepared to finance his purchases by other means.

From the foregoing it is apparent that the main function of mercantile credit is to facilitate the exchange of goods from the producer to the consumer. It is manifest that a merchant requires credit for only so long a time as it takes him to turn over the goods purchased. The terms of credit are also dependent upon the facilities for easy purchasing and quick delivery.

Formerly it was necessary to give very long time credit. The retailer came to the jobber once or twice a year to make purchases. Travel facilities were extremely poor and the journey was a long one, causing a great loss of time to the retailer. The retailer, for that reason, had to be satisfied with trips at infrequent intervals. As a result the retailer was compelled to estimate the demand far in advance of the season, and naturally he bought a large stock. The shipment of the goods likewise consumed a very long time. Necessarily then, long term credit, from six to twelve months, was extended. The jobber then required a promissory note from the retailer, so that he might discount it at his bank and raise funds to continue his business.¹ The retailer's periodic visits to the jobber brought about a close personal contact and relationship between them. This relationship was at that time practically the sole basis of credit granting. At any rate the jobber relied almost entirely on his ability to judge the credit risk from these personal meetings. There were practically no other facilities for gathering information regarding the credit standing of the retailer.

Conditions to-day are entirely changed. The telephone, the telegraph and the modern mail service have made it possible for the retailer to place an order in a minimum time in accordance with present or immediately pending demands. The improved means of transportation, the railroads and faster ships, reduce the time consumed and hazards of shipment. No longer is it considered necessary to extend the terms

¹ See page 41, *supra*.

of credit required by the older conditions. Moreover, the extensive development of banking and the more liberal banking accommodations have been an incentive for the business man to look to his bank for loans. With the proceeds of the bank loan the merchant may pay his bills promptly and effect savings by taking advantage of discounts. Then too, where long term credit is given, higher prices must inevitably be obtained to compensate the seller for the increased risk and the interest on the capital tied up in the merchandise sold. All of these factors have contributed in bringing about a condition of shorter credit terms.

TERMS OF CREDIT

Purchases are now usually made on terms ranging from ten days to six months; longer terms are exceptional. The average term in the United States to-day is from thirty to ninety days. The terms vary with the different lines of business. Terms granted by different houses in the same line have sometimes varied. Terms extended to different customers of the same house are now and then not the same. There is no rigid rule as to the length of credit granted; the extension of credit being largely dependent on individual conditions. The tendency, however, is undoubtedly to extend credit only long enough to give the purchaser an opportunity to realize on the merchandise purchased. Thus we find thirty to sixty days the prevalent terms in the grocery trade. In the jewelry trade, where the average turnover is less frequent, we

find from sixty to more than one hundred and twenty days given.

DISCOUNTS

Where credit is extended, a premium or discount is usually offered the purchasing house for cash payment. The amount or rate of discount varies quite as widely as do the terms of credit extended. As a rule the rate of discount varies directly with the term of credit extended.

If the term of credit were thirty days and the discount given for cash two per cent, the invoice would be marked 2/10 net 30, meaning 2 per cent discount is allowed if paid within 10 days, otherwise the net or full amount of the bill is due 30 days after date of invoice. Under these terms, one who buys a bill of goods amounting to \$1,000 on March 1, 1916, may deduct \$20 if he pays the bill on or before March 11. If the purchaser does not pay on March 11, he loses the discount. In the latter case the purchaser practically pays \$20 for the use of \$980 (the amount he could have paid March 11) for 20 days (the interim between March 11 and March 31, the day the bill is due and is supposed to be paid). In other words, the purchaser in this case pays at the rate of 37.2 per cent a year for the use of the money or goods, by not paying within 10 days and taking advantage of his discount. Measured in terms of discount, the discount in the same case would amount to 36 per cent a year. In different businesses the rate of discount varies all the way from six per cent to seventy-two per cent a year.

COMMERCIAL VERSUS BANKING DISCOUNTS

In the great majority of cases the discount given by mercantile houses is considerably larger than the discount charged by banks for lending funds, so that, for one able to do so, to borrow from the bank and pay cash and take advantage of discounts offered would be extremely profitable. Competitive business conditions now demand that a merchant must, wherever possible, take advantage of discounts in order to leave him a sufficient margin of profit.

Banking loans are far more difficult to obtain than mercantile loans, and that is the reason why there is such an evident difference in rates of discount. One must be able to measure up to higher credit standards to borrow money from a bank than to purchase merchandise on credit. The explanation of this difference in credit standards lies in the fact that the mercantile house as a rule has a wider margin of profit than the bank and can therefore take greater risks. Obviously, then, a merchant who has not sufficient working capital and who is not able to secure adequate banking accommodations will be unable to effect the savings possible through taking advantage of the mercantile discounts. However, there are some merchants who are able to pay cash, but who either through ignorance or carelessness sometimes neglect to take advantage of discounts, and suffer a consequent loss in their profit.

CASH, C. O. D. AND C. B. D. TERMS

Sometimes when a purchaser is in poor credit standing the seller does not desire to extend any credit, or to assume any risk. There has been so much misunderstanding about this very point, that it seems necessary to classify the meaning of different terms where the intention of the seller is to extend no credit. In only one case does the seller assume no risk and extend no credit; that is where the purchaser pays cash before the goods are shipped. The common expression for such terms is "C. B. D.", cash before delivery. Where goods are sent "C. O. D.", cash on delivery, or "sight draft with Bill of Lading attached," the purchaser does not pay until the goods, merchandise or bill of lading is delivered to him.¹

The seller here assumes the risk of having the purchaser refuse to accept the goods, in which case the seller would lose the freight both ways, unless he were fortunate enough to sell the same goods to another merchant along the same route. Realizing that, scheming merchants, to whom the seller will not grant credit, frequently order goods shipped C. O. D. Upon

¹ When goods are sent C.O.D., it is usually the desire of the seller that the purchaser shall be given no credit. The seller, therefore, should demand currency or a certified check and should refuse to accept a check of the purchaser. It is quite possible that the bank on which the purchaser's check is drawn may not have sufficient funds of the purchaser to honor the check. Numerous other contingencies might arise to prevent the bank's honoring the check, and the seller who does not wish to extend credit should never accept a check in payment, unless it is certified by a solvent bank.

the arrival of the goods, these merchants, pleading lack of immediate funds, refuse to accept the goods in accordance with the original terms. Instead they ask the jobber to allow them to take the goods and remit in ten days. Thus they hope to compel the jobber to extend credit. The seller should be on his guard against such merchants and should demand a deposit before the goods are shipped to cover the risk involved.

In another case, when goods are sold for "cash," many merchants are possessed of the mistaken idea that no credit is extended. Such is not the case. Where goods are shipped "cash," there is an expressed or an implied understanding that the purchaser is given ten days' credit. The ten days is allowed him to check the goods received and verify the invoice. The bill is due at the end of ten days and, if not paid, the seller can resort to only the same remedies that are open to any other credit grantor. The credit standing of one to whom goods are sold on "cash" terms should be just as thoroughly examined as one who is sold on regular terms, for practically the same moral risk is involved in both cases.

DATING

Similar in many respects to the giving of discounts, is the custom of dating ahead. By dating ahead is meant that the terms of discount do not begin to operate until the expiration of the period of dating. The theory of dating is simple enough, but custom in various lines of business has imposed on its practical appli-

cation some seemingly peculiar interpretations. For example, in the lace goods and silk goods business the regular trade terms are "7/10—60,"¹ which means that 60 days dating is given, and that 7 per cent discount is allowed if the bill is paid within 10 days after the 60-day dating. Let us assume, for example, that a merchant buys a \$1,000 bill of goods January 1, 1916, on the terms "7/10—60." The practical working out of such terms would be as follows: The bill less discount (\$930) is due in 70 days, that is, on March 10, and if paid on March 10, the merchant may deduct 7 per cent from the gross; that is pay \$930. The purchaser, however, has the option of paying any time before March 10. By virtue of trade custom, if the merchant pays on or before January 11 he can deduct an extra 1 per cent from the *gross*, i.e., pay \$920. If he pays between January 11 and March 10, he can deduct from the *net* amount of \$930 interest at the rate of six per cent a year.

Theoretically and legally, if the bill is not paid until March 10, the purchaser is not entitled to deduct any discount and the seller can legally demand payment of the gross amount of \$1,000. The forfeiture of the \$70 discount is considered a penalty imposed to compel prompt payment. This legal rule, however, has been greatly modified in commercial practice, the degree of modification depending to some extent upon the policy and position of the selling house. Thus we find a great many selling houses permit the purchaser, if he pays after March 10, to deduct 7 per cent from the gross, and add to the net amount (\$930) interest at

¹ Sometimes written "7/10—60 extra."

the rate of six per cent a year, or, in some cases, at the rate of one per cent a month.¹

It would appear therefore in this case, that the 7 per cent discount is not a discount at all, but merely a masque for the real selling price, and further that the dating is just another way of stating the time credit is extended. The bill is really only \$930 and is due ten days after the period of dating. The adding of interest is simply a measure to stimulate prompt payment. The *extra* per cent allowed off the gross for payment within 10 days after goods are shipped is the true discount.

The same custom is found in many other lines of business. The regular terms in the cotton goods business, for example, are "2/10—60 days dating," which means the bill less 2 per cent is due in 70 days; an extra discount of 1 per cent is allowed in lieu of the dating for payment within 10 days; and interest on the net is deducted if payment is made between the 10 and 70 day periods.

SEASON DATING

Another form of dating is season dating, the terms of which vary with the different lines of business,

¹ Even where the rule has been thus modified, if the selling house places the account in the hands of an attorney for collection, the practice is for the attorney to collect the gross amount, and allow no discount deduction. Likewise, in case the purchaser becomes bankrupt, the seller may legally file his claim for the gross amount.

some ninety days, some six months, some eight months. Season dating is used to induce a merchant to order goods in advance of production or importation. A merchant, for example, may order Spring goods the preceding Fall. The risks of change in style, bad business conditions, and lack of demand, are thus transferred from the manufacturer or importer to the retailer or secondary manufacturer. For this reason the seller is willing to compensate the purchaser by extending very favorable terms of credit.

Season dating may work out as follows: Upon receiving the order the manufacturer immediately begins to make the goods, or the importer immediately orders them from abroad. As soon as they are ready, probably December or January, the goods are delivered and an invoice sent to the purchaser. The invoice is given the season dating, say May 1, and the regular terms of discount do not begin to operate until then. The purchaser, however, may pay at any time before May 1 and may deduct interest at the rate of six per cent a year from the *net* amount of the bill. The distinct advantages to the seller are that advance orders induced by season dating transfer the risk of changes in fashion to the purchaser and enable the manufacturer better to gauge his production. On the other hand the seller must give very long term credit. The purchaser enjoys the long term credit, for it allows him plenty of time to sell the goods. The purchaser, however, must carry more insurance and provide larger quarters for the stock. Moreover, there is the danger that the purchaser, encouraged by the long term season dating, may optimistically overesti-

mate the demands of the coming season, overstock with merchandise, and subsequently sustain heavy losses through having on hand out-of-style and unsaleable merchandise.

END OF MONTH TERMS

A more recent development that has had a decided tendency to lengthen the terms of credit has been the creation of "end of month"¹ terms. Merchants who were doing a very active business and made purchases almost every day during the month found it very inconvenient to make payments every day during the month; and yet this would be necessary if they were to avail themselves of the cash discounts. The larger merchants who were such active buyers requested the selling houses to permit them to pay all their bills once a month and take advantage of the regular discount. The selling houses granted this request for they wished to keep the good-will and business of such active accounts. In this way arose the custom of permitting large houses to pay on the tenth day of the month all the bills of the previous month and deduct the cash discount. In other words, goods shipped between January 1 and January 31, would be dated February 1. Such terms are, of course, created only by special agreement and not by trade custom. Some houses have amended the "end of month terms" to the extent that goods shipped between the first and fifteenth of January are dated January 15, and goods shipped between January 15 and 31 are dated Feb-

¹ Frequently abbreviated E. O. M.

ruary 1. These terms are far more equitable to both seller and purchaser than are the former, for certainly few purchasers can plead inconvenience in making semi-monthly payments.

The "end of the month" terms have been subject to serious abuses. Some houses enjoying the privilege of end of month terms have adopted the scheme of stamping on their orders the following notice: "All shipments made between the twenty-fifth and end of month are to be considered dated as first of following month, subject to end of month terms." Obviously this is a mere subterfuge for compelling the extension of thirty days' extra credit. Another insidious scheme purchasing houses have resorted to in an effort to extend the terms of credit, is that of sending a department buyer to the selling house to make a purchase. The department buyer informs the selling house that he has bought up to the limit allowed him during the current month, but that he will place a certain order if the goods are billed the following month. This practice is to be no less sharply condemned than the one mentioned above, for it compels the selling house unwittingly to give a decided preference to one customer over all others.

R. O. G. TERMS

All invoices are dated the day goods are shipped. If a house in New York sells goods throughout the country on "2/10 net 60" terms, it is very apparent that a house in Jersey City would enjoy a distinct advantage over a house in San Francisco. The former

would receive its goods within twenty-four hours and have time to check them up before paying within ten days, while the house in San Francisco would probably have to pay before the goods are received in order to take the cash discount. To overcome this disadvantage to distant purchasers, many houses date invoices to some of their customers "receipt-of-goods,"¹ which means the time allowed for taking discount is measured from the time the goods are received by the purchaser. If the purchaser, however, does not avail himself of the discount within the period allowed, the regular terms are usually measured from the date of shipment. The purchaser then enjoys the benefit of R. O. G. terms only when he takes advantage of the discount. By special agreement these terms are extended by many eastern houses to the larger firms located in the West and on the Pacific Coast.

¹ Often abbreviated R. O. G.

CHAPTER V

THE DUTIES AND QUALIFICATIONS OF THE CREDIT MAN

Not many years ago credit was dispensed by the proprietor of an establishment. He made it a point to come into personal contact with his customers at their periodic visits to his place of business. In this way the proprietor was able to determine the quality of the risk by personal observation. With the development of the country and the attendant growth of business and the increase in the number and variety of accounts, it became necessary to have salesmen travel to every section of the country, and no longer did the proprietor come into personal contact with most of his customers. For these reasons he delegated part of the responsibility of passing on the credit risks to the bookkeeper. At first the bookkeeper found himself equal to the task. Later, however, with a still greater intensification of trade, it became necessary for the bookkeeper to be as well informed regarding the status of a concern in Maine or in California as of the status of one doing business in his own city. With this intensification of trade, numerous agencies for obtaining credit information, concerning the credit worth of debtors, were established. As these sources of information multiplied, it became a physical as well as an

intellectual impossibility for the bookkeeper, burdened with his routine duties, to attend properly to the credit division of his institution. The outcome of these conditions was the employment of a specialist, an expert, to study credit from the proper standpoint and to manage the activities of the credit department. To fill this position it was necessary to have a man who not only occupied himself with the onerous work of looking after accounts, but also with the vital task of constructively building up the sales. He was to have a prominent part in, if he did not control, the promotion of sales, the life of a business. Thus the "credit man" came to assume many and responsible duties.

DUTIES OF THE CREDIT MAN

Let us now examine the duties of this important professional credit man who was thus evolved in the course of industrial expansion. At the outset we must bear in mind that the fundamental aim of all trade is to make profit. This aim is attained through the stimulation of the profitable sales through the channels of industry. It is the task of the true credit man to engineer this progress of sales. This phase of the credit man's work is often not considered, yet it is very important. We must therefore emphasize the fact that the credit man's duty is not simply to reduce losses. To reduce losses only would be a comparatively easy task, for it would not be very difficult to substantially eliminate bad debts, provided the credit man were to decline to take all but A1 risks. It is obvious, however, that with such a policy his firm

would lose considerable business. A credit man whose conception of duty is narrowly restricted to the limitation of losses would become an obstacle to the main purpose for which the business is organized, viz., of making profit from sales. While a credit man, therefore, should be keen in detecting unsafe risks, he must ever bear in mind that the taking of the legitimate risks is the essence of business. The above observations can be summarized in the following maxim: The function of the credit man is to have a minimum of losses with a maximum of sales.

A discussion of the duties of the credit man, then, can be subdivided as follows: *First, keeping down losses; second, increasing sales.* To attain this double object, the credit man must have a well organized department, trained assistants, and a thorough co-operation with the sales department. These will be discussed in detail in a later chapter. At this point, however, it is appropriate that we briefly consider the immediate work of the credit man.

FAMILIARITY WITH THE ACCOUNTS

In the first place, the credit man must be reasonably familiar with the accounts on the ledger. In a general way he should have a fairly accurate knowledge of the activity of each account, including the average amount of purchases made by the customer during different seasons of the year, the amount of indebtedness, and the manner of making payments. This knowledge is necessary to enable the credit man to recognize uncommon activity or other unusual developments affect-

ing any account. The information is likewise very important when the credit man is considering extending further credit or checking new orders.

To bring this information to the attention of the credit man various methods, more or less scientific, are used. The usual method followed by most credit men is to rely on their own memory as far as possible. Thus, when checking an order the credit man instinctively calculates in his mind the status of the account, and, should he not be satisfied with his knowledge of any particular account, he will refer to the ledger.

However, if the credit man personally were to refer to the ledger, he would be unduly interrupted in his work and lose considerable time in going to and from the bookkeeping department, which is usually located in another room. Furthermore, were the credit man to inspect the ledger, he would probably delay the work of the bookkeeper. To avoid these interruptions and delays, a ledger report form to be filled out by the bookkeeper at the request of the credit man has been devised. This form is reproduced herewith.

This form can also be used by the bookkeeper in calling the credit man's attention to abnormal circumstances that seem to require attention, such as unusual activity of an account, purchases by a debtor who is owing for bills after maturity, past due accounts, etc. The usefulness of this system obviously depends upon the extent to which the credit man has trained the bookkeeper. The credit man does not rely entirely on the bookkeeper, however, for occasionally the

Date, _____

Ledger Report

Name _____

Address _____

Business _____ Salesman _____

How long sold _____

Highest recent credit _____ Date _____

Terms _____ How much owing _____

How much due _____

Payments (past) _____ (present) _____

Rating _____ Date of last trade look-up _____

Remarks _____

credit man personally glances at the ledger accounts, especially the doubtful ones.

KNOWLEDGE OF THE BUSINESS OF CUSTOMERS

In the second place, the credit man should have knowledge of the essential elements in the business of his customers. For example, he should have information on the kind of business in which his customer is engaged and the general prospects for that business. The financial strength and efficiency of the customer's organization should also be known to the credit man. Moreover, he should be familiar with the competitive and other local conditions affecting his customers so

that he may better understand the causes of any decline that might occur in the financial strength of a customer. Where and how information on these and other points mentioned in this chapter can be obtained will be fully discussed in the chapters on Sources of Information.

CARE IN OPENING NEW ACCOUNTS

In the third place, having acquired adequate knowledge concerning all the accounts now on the books, the credit man should exercise particular pains in opening new accounts. In fact, before any new account is accepted, sufficient information concerning it should be obtained and then carefully analyzed. How to analyze information is discussed in subsequent chapters. If it appears that the new credit applicant cannot meet the credit standards of the house, the credit man should not hesitate to refuse the account. Of course, it may sometimes be advisable to be indulgent with old customers, but there is no obligation on the part of the credit man to check a first bill to a concern that has not established a satisfactory credit standing, or to open the account of a newly organized enterprise, in the composition of which he cannot see the elements of success. In fact, as a scientific credit grantor, he should absolutely decline credit to such an applicant. Such action is for the interest of the prospective customer as well as for the whole credit community. It is by extending credit to the incompetent and undeserving that the credit

system is abused and becomes a menace to sound business.

NOTING THE PROGRESS OF ACCOUNTS

In the fourth place, the credit man should be vigilant in noting the progress of accounts already on the books and new accounts opened. This, on account of the fact that conditions affecting credit are continually subject to change. A majority of the notices of failures come like bolts of lightning out of the clear sky, and one of the pangs of the conscientious credit man is to find at the time of a failure that his records are not up-to-date—and that an opportune revision of his files would have enabled him to avert the loss. Naturally it is not advisable to have too much or duplicity of information, but the credit man should have knowledge sufficiently recent to free him from the necessity of acting entirely on blind faith based on past performances. There are various methods for keeping information up-to-date which are discussed under Sources of Information.

In the fifth place, if it appears from watching the progress of the accounts that any accounts are becoming vitally weakened the credit man should prune those accounts from the books. Weakness in an account is usually disclosed by the financial statement or by persistently slow payments. When it appears that weakness is fundamental and practically incurable, the credit man should apply himself tactfully to the task of eliminating the account. On the other hand, if the account is merely temporarily weakened and will probably recover with the proper guidance and assist-

ance, the credit man should give all reasonable aid to the account. How this may be done will be discussed later.

MAKING COLLECTIONS

Sixth, after the credit has been extended to a customer and the credit term has expired, the credit man must take the necessary steps to collect the account. This may even involve a law suit for the price of the merchandise, or, in some cases, an action for the recovery of the goods themselves. The credit man must know what his remedies are and what steps he should take to collect an account. In case of the embarrassment or insolvency of an account, a friendly adjustment or settlement may be necessary and advisable. Or it may be better to place the debtor in bankruptcy, in which case the credit man must be able to follow the collection of an account through the bankruptcy proceedings. To this end a knowledge of the Bankruptcy Law is essential. All of these matters are treated in detail under the chapters on Collections, Creditors' Remedies, Adjustments and Bankruptcy.

KNOWLEDGE OF LOCAL CONDITIONS

Seventh, the credit man should have knowledge of conditions affecting different sections of the country as well as particular localities.

This duty of the credit man is readily understood when it is remembered that the debt-paying ability of a community is governed by its prosperity. But the

prosperity is governed by many conditions which must be studied intensively and in detail. For example, poor crops in an agricultural district, and unemployment or strikes in a manufacturing district, seriously impair the debt-paying ability of the consumers and in turn the retailers in those districts. So, too, tariff changes or other governmental actions may have an important bearing on the industrial activity of certain sections, and in turn affect the credit conditions in those sections. The shifting of population following a change in the location of a large industry will also influence the condition of retailers there.

With all of these and other local and industrial factors contributing to the progress or retrogression of trade the true student of credits should be familiar in order to be prepared scientifically to regulate the extension of credit.

STIMULATING SALES

Eighth, the credit man should actively assist in stimulating and promoting sales. This is accomplished, first, by engendering the spirit of co-operation with the sales department; and, second, by winning the good-will of customers. The credit man comes into contact with the customer at the most delicate point of business relations. The credit man must reasonably trust his customer and win the latter's confidence. The credit man, by giving the customer assurance of proper and fair consideration, can very often do more to foster the business of an account than can the most aggressive sales department.

CO-OPERATION WITH OTHER CREDIT MEN

Ninth, the credit man should co-operate with other credit men for the mutual benefit of all. Not many years ago, to give to another firm information regarding an account was regarded as harmful disclosure of trade secrets. Some facts were given upon inquiry, but only with considerable reluctance. The growing complexities of credit work, however, the development of agencies, and the organization of credit men in the National Association of Credit Men and its constituent smaller bodies, have gradually taught the merchant to be liberal in giving credit information. At present the need for exchange of ideas and facts is so well recognized that experiences relating to the credit of the customer are readily imparted. Such information is freely given, even among keen business rivals with but little abuse of confidence. Sometimes, of course, discretion must be used to protect the interests of the customers as well as of the house. In the case of an account in prime standing, for example, it is not necessary to give actual figures indicating how big the account is; nor is the credit man justified in gossiping regarding delicate facts affecting the condition of his customers. At all times, however, the credit man should give information sufficient to present the true condition in the right light to the interested inquirer and under all circumstances should avoid saying anything which is expressly or impliedly misleading.

Briefly, reviewing the duties of the credit man, we find that he serves his house best in the following

ways: first, by reducing losses to a minimum through wholesome interest in his accounts; second, by fostering a maximum of sales through proper co-operation with the sales department and considerate treatment of customers, and, third, by contributing to the proper regulation of credit in general by true co-operation with other credit men and constant study of commercial and industrial conditions.

PERSONAL QUALIFICATIONS OF THE CREDIT MAN

To cope in a full measure with the various duties that have been mentioned, the credit man must measure up to the following severe requirements:

(1) He must be a man of sterling character, with courage to deal squarely with weakened accounts, and the ability to say "NO" when necessary. His honesty must be unimpeachable; thus, and thus only can he command the respect of the customer as well as of all his fellow credit men.

(2) He must be of analytical mind—competent to digest various kinds of information, to see facts in their proper proportions, and to separate the superficial from the substantial in arriving at a conclusion.

EDUCATIONAL QUALIFICATIONS OF THE CREDIT MAN

It is true that some of the most efficient credit men of to-day acquired their knowledge in the hard school of actual business experience. They are prepared to solve their problems by virtue of crystallized knowledge obtained through years of experience. In gen-

eral, however, a credit man, to be best equipped to meet the complex problems of to-day, must supplement his knowledge gained in narrow daily routine by facts acquired through diligent study. Among the most important subjects with which he should be familiar are these:

(1) Accounting. A credit man should be able not only to analyze satisfactorily a financial statement, but also when necessary to go over the books and financial affairs of a customer.

(2) Corporation finance. With the tremendous increase in the corporate method of doing business among small concerns as well as big, the credit man finds new problems with which he can cope only through understanding the principles of corporation finance.

(3) Commercial law. The credit man must know the elements of the law of contract and sales. He also finds indispensable a practical knowledge of the bankruptcy laws and the other laws governing the rights and duties of debtors and creditors.

(4) Economics. The credit man should understand thoroughly the fundamental organization of business, the various legislative acts, such as the Currency Bill, and the Tariff Bill, and the other economic phenomena that affect the credit conditions of the community.

(5) Psychology. The study of this science will assist the credit man in properly understanding many credit risks. In this study, however, a credit man is best schooled by his actual daily experiences.

(6) Banking practice. It is also well for a credit man to have an intelligent understanding of banking practice, and to be sufficiently versed in insurance and real estate to grasp the significance of these factors in relation to the credit risk.

CHAPTER VI

ELEMENTS DETERMINING THE CREDIT RISK

Credit, as we have observed, is a vital force in the promotion of trade. It is obvious, however, that the purpose of increasing profits through the agency of credit as a trade builder will be defeated if the losses caused by poor credit judgment exceed the gains resulting from the increased business. The perplexing question, therefore, that is always occurring to the sales department, the credit department and to the merchant himself, is: Is the credit good?

THE POLICY OF THE HOUSE

The all-important question of whom to trust must in practice be viewed by the credit departments from different angles. In the first place, in making its decision as to acceptable risks, the credit department must look at the problem from the standpoint of the policy of the house. The credit department is not concerned primarily with risks that are unquestionably good or irredeemably poor; these are relatively few. It is rather the great majority of intermediary hazards with which the credit department has to deal. Amid this large class the locus of the line of division between acceptable and non-acceptable risks depends largely upon

policy. In other words, business enterprises organized on a basis of large scale production, or merchants engaged in keenly competitive industries or in the sale of commodities yielding big profits, may find it advisable to adopt a very liberal credit policy. On the other hand, manufacturers possessing such monopolistic advantages arising from branded or copyrighted goods that dealers are more or less compelled to buy from them, or traders and merchants operating on a small margin of profit, are inclined to be more exacting and conservative in dispensing credit.

THE ATTITUDE OF THE CREDIT MAN

Besides the policy of the house as determined by the exigencies of the business, the decision of the credit department is further influenced by the attitude of the credit man himself. Some credit men pride themselves upon the low percentage of their losses, forgetting that there may be greater loss in profits because of the curtailment in sales caused by their credit methods. The credit man who is unwilling to take a fair business risk is certain to divert business from his house, for, as a rule, a customer "turned down" is forever lost. On the other hand, the credit man, who grants credit too freely, rolls up excessively large losses for his house and contributes to the general business demoralization created by the undue inflation of credit. It is the aim of every well regulated credit department to avoid these extremes of a too free or a too narrow policy. It is true that firms considered excellent risks sometimes fail, and that those looked

upon as being poor hazards sometimes develop successfully. The chances are opposed to this, however, and the factor of safety for the management is immeasurably higher in the middle course.

THE BASIS OF CREDIT

The controlling factor in granting credit is confidence. By confidence we mean the feeling of assurance as to the debtor's ability and willingness to pay his bill at maturity. It is based upon three elements which constitute the essentials underlying the granting of credit—namely, character, capacity and capital.

Character is the essential of primary importance. It is the essence of the credit problem, for men deficient in character cannot be trusted. In his remarks before the Pujo Investigation Committee the late J. P. Morgan said, "Character is the fundamental of banking."¹ How much more forcibly this principle ap-

¹ The following is an extract from the testimony of J. P. Morgan as reported in the *Money Trust Investigation*, Vol. II, p. 1084:

Mr. Morgan. I have known a man to come into my office, and I have given him a check for a million dollars when I knew he had not a cent in the world.

Mr. Untermeyer. There are not many of them.

Mr. Morgan. Yes, a good many.

Mr. Untermeyer. That is not business?

Mr. Morgan. Yes; unfortunately it is. I do not think it is good business, though.

Mr. Untermeyer. Commercial credits are based upon the possession of money or property.

plies to mercantile credit is apparent when we realize that the specific collateral frequently supporting banking loans is absent in business transactions. It goes without saying that the giving of merchandise without any security upon the promise that payment will be made at a future date, should be restricted absolutely to the trustworthy.

The credit man, however, must not only feel sure of the character of a prospective risk, but must also possess a reasonable knowledge as to his ability to make good on his obligation. In other words, when the credit department is satisfied as to the good moral qualities of an applicant for credit, it must then decide how much credit is to be given. What is the applicant's capacity? If he is given too much credit, he will be in as bad a predicament, if not worse than, the

- Mr. Morgan. What?
- Mr. Untermeyer. Commercial credits?
- Mr. Morgan. Money or property or character.
- Mr. Untermeyer. Is not commercial credit based primarily upon money or property?
- Mr. Morgan. No, sir; the first thing is character.
- Mr. Untermeyer. Before money or property?
- Mr. Morgan. Before money or anything else. Money cannot buy it.
- Mr. Untermeyer. So that a man with character, without anything at all behind it, can get all the credit he wants, and a man with the property cannot get it?
- Mr. Morgan. That is very often the case.
- Mr. Untermeyer. But that is the rule of business?
- Mr. Morgan. That is the rule of business, sir.

man who cannot obtain adequate credit, for he will be tempted to over expand his business.

To gauge the credit capacity of an applicant, the credit man turns naturally to a study of the third "C"—capital. The financial status of credit applicants and debtors will be more thoroughly discussed later when we analyze financial statements. Suffice it to say in this connection, however, that not only the amount of capital but also the efficiency with which it is used must be considered by the credit department. The data necessary to secure this information are usually found in past experience. The efficiency of capital in particular measures the capacity of the applicant, for it indicates the amount of careful consideration that he has heretofore given to his use of credit and also the extent of economy in the organization and administration of his business.

To summarize, therefore, we can state the credit equation as follows:

Character + Capacity + Capital = Limit of Credit.

Character must exist in full measure if any credit at all is to be given. This question being decided, the determination of the limit of credit involves a study of the varying proportions in which the other two elements, capacity and capital, are present.

POINTS TO BE INVESTIGATED

The points to be investigated before credit is extended may be summarized as follows:

First: Personal character, which includes (a) habits of living and spending, with particular regard

to the social ambitions of the applicant's wife, (b) tendencies to drink or gamble to excess, (c) truthfulness and respect for business engagements.

Second: Business ability, which takes into account (a) age and experience, (b) energy, aggressiveness, common sense and shrewdness, (c) ability to organize and direct subordinates, (d) technical knowledge of the business itself, (e) general education and training making for broad mindedness in business, (f) buying and selling methods, (g) success in this or other lines of business, (h) location of business with special reference to population, prosperity of the community and present or potential competition.

Third: Financial condition, under which is considered (a) balance between assets and liabilities, and nature of each, (b) relation of current assets to current liabilities and turnover of stock, (c) insurance carried, (d) method of paying debts, (e) proportion of capital invested and borrowed, considering also whether the capital was acquired by saving, gift, inheritance, speculation or otherwise.

How to obtain information on these points will be treated in the following chapters on "Sources of Information."

CHAPTER VII

SOURCES OF CREDIT INFORMATION

THE GENERAL AND SPECIAL AGENCIES

Fundamentally, credit granting is based on knowledge relating to the character, capacity and capital of the customer. Of the various sources of obtaining such information, the one best known and most commonly used is the mercantile agency. This may be defined as an organization formed for the purpose of ascertaining the credit position of persons engaged in trade and of circulating this information among its members and subscribers.

Mercantile agencies are divided into two classes, general and special. The special agency limits its field of operation to particular lines, such as jewelry, millinery, textiles, garment manufacturers, furniture and carpets, etc. Agencies of this character are, of course, very valuable. On the other hand, the general agencies cover a vastly larger field and are organizations of really tremendous magnitude. They are so universally used and are such potent forces in the credit world that it seems best to devote this chapter entirely to a discussion of their origin, organization and methods of operation.

We have seen how commerce has developed from

the early stage when trading was limited to an "exchange of goods for goods" or barter, through the period when merchants, coming to market to make purchases, brought their wallets in order to make immediate payments in money, down to the time when the growth of business induced merchants to trust those with whom they had become personally acquainted, by shipping goods to them in exchange for a promise to make payment at a specified future date—in other words, on credit terms. The introduction of the credit system opened the minds of the jobbers and manufacturers to the tremendous opportunities for business building. At a time when travel was uncertain, communication very slow, and transportation facilities weak, the dealer who was located at points distant from the market and was dependent entirely upon his own capital, found his field of activity severely restricted. The wholesalers in the large cities, however, realized this, and foreseeing the possibilities for increased trading, they gradually extended the system of doing business on credit.

In those days there was very little information accessible to the merchant concerning his customer's character, ability and financial strength. The traveling salesman had not yet made his appearance, and the merchant had to depend on his personal knowledge and such vague information as he could obtain through mail inquiries. It is quite obvious that the extension of credit based upon such uncertain data resulted in serious losses. Nevertheless, the additional business it stimulated prompted the wholesalers to continue granting credit in spite of the hazards involved.

Thus matters continued until the crisis of 1837, when a panic occurred that brought destruction to both banks and merchants throughout the country. The losses from bad debts were enormous, and merchants were brought to realize that one of the prominent contributory causes of the ruinous conditions existing was the poor credit system which had made possible overtrading and wild-cat speculation. The immediate effect of this crisis was a recognition of the necessity of closer investigation of credits. This resulted in the establishment of the first mercantile agency.

THE FIRST MERCANTILE AGENCY

This was established in 1841, by Louis Tappan, a New York merchant. Mr. Tappan had made it a point carefully to compile records relating to his large market of customers. These records covered his entire experience with them and showed other information acquired by personal observation and through correspondence. After the panic he began to sell this information, and the eagerness of the other merchants to buy the records encouraged him to found the first business institution organized for the exclusive purpose of gathering and selling credit information.

As to the origin of the business and the commercial necessities out of which it grew, we quote a journal published at that time: "Immediately after the terrible mercantile revulsion of 1837 (are you aware that in 1837 every chartered bank in the United States failed?), when our whole system of internal commerce was prostrate and nearly all its operators bank-

rupt, this agency was planned and put into operation as a remedy for some of the difficulties, that had just been so heavily experienced. Its design was to uphold, extend and render safe and profitable to all concerned the great credit system on which our country had thrived." While, at the beginning, the agency reports were very meagre, the service rendered along these proposed lines was valuable and led to an early improvement in credit conditions.

Louis Tappan had associated with him his brother Arthur Tappan. In 1846 Benjamin Doughlass, who had joined them in 1845, was admitted into partnership and assumed the chief management. In 1849 Louis Tappan retired and his brother Arthur took his place, the firm becoming Tappan & Doughlass. This continued until 1854, when Benjamin Doughlass became sole proprietor. On assuming the sole ownership Mr. Doughlass made his brother-in-law, Robert Graham Dun, a partner, the firm style becoming B. Doughlass & Co. In 1857, the agency began to publish detailed statistics regarding mercantile failures in the United States and Canada. These statistics have become the authoritative standard on this subject. In 1859 Mr. Doughlass sold his interests to his partner and the present firm of R. G. Dun & Co. was formed.

GROWTH OF THE AGENCY

The business after the war grew from humble proportions until it covered the United States and Canada, and it has gradually extended farther. In 1841 the concern had one small room with only half a dozen

clerks who laboriously transcribed in longhand the reports sent to subscribers.

To-day the organization has about 250 branches, 96 of which are located in trade centers outside the United States. It employs a corps of over 10,000 in its offices and has over 100,000 representatives or correspondents in less important commercial centers.

This development did not continue for long, however, before a rival entered the field. In 1848 John M. Bradstreet, a lawyer living in Cincinnati, Ohio, was made assignee of a large insolvent estate. While thus engaged he acquired considerable information concerning the debtors as well as the creditors of this estate, and he made arrangements for the selling of this information to a number of New York concerns. So successful were his operations that in 1849 the business had expanded sufficiently to warrant his opening an office in New York, inaugurating "Bradstreet's Improved Commercial Agency." This is the origin of the enterprise that now embraces the whole commercial world in its investigations. Many other mercantile agencies entered the field of furnishing credit information; each vied with the other in the length of the list of retailers on whom information could be had. This resulted in extremely long lists devoid of any reliable information. Dun and Bradstreet furnished reliable lists and were the only agencies to survive the competition.

The establishment of these agencies was not accomplished without difficulties. It can readily be understood that the retail traders did not encourage institutions which they said contemplated "spying" or

“prying” into their affairs. Moreover, some jobbers opposed the agencies because of the supposed inquisitorial nature of their work. The agencies were also confronted with the question whether they would be subject to the general rules of law in respect to the publication of libels. A mercantile agency, through misleading information, might publish matter libelous and if it were to be deprived of all defence except only that of proof of complete truthfulness, it probably could not be maintained. The courts, however, have ruled that a communication made by a mercantile agency in good faith and without malice, to one of its subscribers upon his request, is made under the law of qualified privilege. Hence, agencies actuated by worthy motive in the reports have been given wide latitude by the courts upon ground of both principle and public policy.

In spite of the above mentioned difficulties, however, the agencies developed, for they were favored by the conditions of the country. Traders were continually appearing in newly settled districts and were constantly migrating from point to point experimenting with business conditions. In view of such a lack of business stability, these traders were reconciled to giving information regarding their qualifications for credit purposes. The unsettled state which followed the Civil War also fostered the willingness of customers to give information. Under these conditions it did not require much time for the agencies to justify their existence. It has been clearly proved that the seller of goods is ready and willing to give credit; he wants only to be satisfied regarding the buyer's respon-

sibility. The buyer is glad of the opportunity to demonstrate his worth in order to obtain the benefits of credit. The agency is an efficient and effective servant of both.

ORGANIZATION OF THE AGENCY

The essence of the agency work is readiness to serve. To anticipate inquiry is the true principle of reporting. For this purpose the country is divided into a number of large districts, comprising one or more counties. In each district there is a central office at which district information is assembled and transmitted to the main offices. Outside of the United States each agency also has a number of branch offices.

Travelling reporters from all branches are continually covering their respective territories. The majority of the merchants are called upon for financial statements showing itemized assets and liabilities. References are obtained, and these as well as other authorities in the trade are consulted. An effort is made to verify the figures given and also to determine the reliability of the references.

In all the smaller towns special correspondents look up new merchants and send in items affecting the standing and responsibility of the existing merchants. In every county seat, generally in the recorder's office, some one is employed to send in daily memoranda of all suits, mortgages, deeds and other instruments filed, which affect any one in the county who is engaged in business. The country districts and outside towns are thoroughly covered, no hamlet or place being too remote to be visited.

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The greatest care is taken in selecting agents and correspondents. Nevertheless, prudence would demand some check upon them. This is done by the agency through travelling reporters, who report upon traders usually without knowledge of what the local agent had previously reported. A comparison of the two reports will bring to light any discrepancies.

The credit man must remember, however, that the report is seldom better than the agent who makes it and that it is only human to err. The credit man will, therefore, profit by supplementing the agency information with the several sources of credit information hereinafter described. Completeness and accuracy of information is absolutely essential.

In the cities the work is done by reporters who have had considerable experience in the office. These men must be just, conscientious, and capable of judging human nature. They must also possess such a personality as will induce business men to impart confidential information to them. These reporters become experts along certain lines. For instance, there are reporters of dry goods, boots and shoes, leather, steel and iron. There are also men posted on conditions in the financial district, who circulate constantly among merchants and bankers and who frequently get the sense of something wrong before it definitely appears on the surface.

When a subscriber to an agency makes an inquiry, his subscription number is put opposite the name and for three years from the date of the inquiry the agency voluntarily advises him of important changes such as news of bankruptcy, assignments, foreclosures, law

suits, suspicious transfers, pledging of accounts receivable, mortgages, fires and serious losses of every kind affecting the person inquired about. The recording of these names also gives the agency a list to be visited by the reporters, when a revised investigation is deemed advisable.

CONTENT OF AGENCY REPORT

The agency report is intended to cover the following points:

1. Antecedents or past record.

This includes usually the date when the business was started; the composition of the firm, if a corporation, the names of the officers and directors, and if a partnership the names of the partners; age and other information about the proprietors or officers.

2. Summary of totals of assets and liabilities of previous statements.

These totals, when given, are taken from annual or other periodical statements previously furnished by the merchant to the agency.

3. Full details of latest statements.

This statement is usually one made by the merchant. The agency tries whenever possible to obtain a statement over the signature of the merchant. The advantage of obtaining signed statements will appear later.

4. Comments regarding figures contained in statements.

These comments are made by the employees of the agency.

5. Character, habits, and business capacity.

Under this head a brief history of the business is usually given in narrative style. The importance of this information is that it may enable the credit grantor to discover traces of dishonesty where it exists.

6. Comments regarding store, location, business outlook, etc.

The reporter of the agency gives his opinion on these points, and, of course, his opinion should be substantiated by other information by the credit grantor.

7. Credit standing,—itemized trade opinions and experiences of other creditors.

Here we find the opinions of houses dealing with the merchant in question. These comments deal with the debtor's manner of meeting his business obligations. The names of the houses are not given, and the credit man should bear in mind that different houses have entirely different standards of judging a debtor. Without the name of the house giving the opinion, the credit man is at a loss to know what standard has been adopted as the basis of the opinion.

RATINGS

Another function of the agency is to give ratings. These consist of two elements, capital and credit. The accompanying schedules indicate the rating symbols used by the agencies.

The ratings are condensed conclusions, first, denoting capital and indicating the estimated net worth after verification and allowances for shrinkage, etc.; and second, denoting grade of credit and intending to re-

R. G. DUN & CO. RATINGS

ESTIMATED PECUNIARY STRENGTH			GENERAL CREDIT			
			High	Good	Fair	Ltd.
AA	Over \$1,000,000.....		A 1	1	1½	2
A+	Over \$750,000.....		A 1	1	1½	2
A	\$500,000 to \$750,000.....		A 1	1	1½	2
B+	300,000 to 500,000.....		1	1½	2	2½
B	200,000 to 300,000.....		1	1½	2	2½
C+	125,000 to 200,000.....		1	1½	2	2½
C	75,000 to 125,000.....		1½	2	2½	3
D+	50,000 to 75,000.....		1½	2	2½	3
D	35,000 to 50,000.....		1½	2	2½	3
E	20,000 to 35,000.....		2	2½	3	3½
F	10,000 to 20,000.....		2½	3	3½	4
G	5,000 to 10,000.....		...	3	3½	4
H	3,000 to 5,000.....		...	3	3½	4
J	2,000 to 3,000.....		...	3	3½	4
K	1,000 to 2,000.....		...	3	3½	4
L	500 to 1,000.....		...	...	3½	4
M	less than 500.....		...	...	3½	4
Where only a Credit Rating appears this line of Credit designation applies			1	2	3	4

fect the past record, ability, and business prospects. Thus, if the agency concludes that the estimated wealth is from \$35,000 to \$50,000, and credit grade second, it would be shown as follows: Dun Agency, D₂; Bradstreet, R—C. These ratings are compiled in books issued by the agencies quarterly to the subscribers. That published January, 1916, contained nearly 1,900,000 names. The book is arranged alphabetically by states, cities and smaller corporate divisions, while the names of the merchants in any city are arranged alphabetically under that city. For the convenience

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BRADSTREET RATINGS

ESTIMATED WEALTH		GRADES OF CREDIT		
G	\$1,000,000 and above.....	A a	A	B
H	500,000 to \$1,000,000.....	A a	A	B
I	400,000 to 500,000.....	A	B	C
J	300,000 to 400,000.....	A	B	C
K	250,000 to 300,000.....	A	B	C
L	200,000 to 250,000.....	A	B	C
M	150,000 to 200,000.....	A	B	C
N	100,000 to 150,000.....	B	C	D
O	75,000 to 100,000.....	B	C	D
P	50,000 to 75,000.....	B	C	D
Q	35,000 to 50,000.....	B	C	D
R	20,000 to 35,000.....	C	D	E
S	10,000 to 20,000.....	C	D	E
T	5,000 to 10,000.....	C	D	E
U	3,000 to 5,000.....	D	E	F
V	2,000 to 3,000.....	D	E	F
W	1,000 to 2,000.....	D	E	F
X	500 to 1,000.....	E	F	....
Y	0 to 500.....	E	F	....

of travelling salesmen and others the agencies publish the rating books in state editions of smaller size. These editions can be had only by those who are subscribers to the large books.

THE USE OF RATINGS

The ratings are intended to serve merely as an index to the contents of the reports and the cautious credit man is seldom guided by ratings when considering a risk of any fair amount. He wants to know all the details and to reach his own conclusion, which may be entirely different from the opinion of the edi-

tor of the books. Besides, he realizes that the ratings in the books are subject to considerable revision. There are about 300,000 changes every month. In other words, the rating was perhaps correct when the book was printed, but misleading to-day. It is interesting to note, however, that in a recent year, out of 14,047 failures, 13,187 or 93% had nominal or no credit ratings, 766 were rated good, and only 94 were rated very good or highest.

Ratings are sometimes useful, however, in passing upon small rush orders, and a poor rating or an unfavorable change in rating cautions the credit man to investigate carefully. They are also serviceable in making periodical revisions of one's credit files. A change in ratings suggests to the credit man that a new investigation concerning his customer should be made. The rating books are also frequently employed in compiling lists of prospective customers, for it is better not to solicit an account that will have to be turned down. Furthermore, the rating, if poor, is a signal to the sales department to avoid the account.

THE FUNCTION OF THE AGENCY

The issuance of reports and the publishing of the rating books constitute the function of the large mercantile agencies. Errors incidental to all human efforts must necessarily creep into a system of such immense scope. Yet, when we compare the chaotic state of affairs which preceded the introduction of the mercantile agencies, with the splendid credit conditions of to-day, we can appreciate the valuable service

that the agencies are rendering. It is largely the activities of the agencies that have kept clear the channels through which trade, wonderfully stimulated by credit, is continually flowing.

The speed and accuracy of the agency service could probably be improved with the credit man's co-operation. Thus, when making an inquiry of the agency, the credit man should give the proper official style of the firm name and the street address, so that the agency correspondent may have little difficulty in locating credit seekers.

In addition to furnishing ratings and reports, the agencies now publish weekly magazines of trade and finance which are recognized authorities on national business conditions. The summary of business conditions which they give is based on reports regularly received from correspondents throughout the United States.

Considered in its broadest aspects, the function of the agency is to keep pace with progress in all matters relating to credit granting. As the pioneers of civilization have pushed forward into hitherto unknown parts of the world, the commercial agency has followed and has furnished credit grantors with information concerning people throughout the entire civilized world who seek credit.

TYPICAL REPORTS

Two actual reports (with the names changed) submitted by the large agencies are given herewith. These reports were selected largely because of the complete-

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ness of information given. Many other reports are not nearly so thorough or understandable. Following the agency report is a "model agency report" submitted by the Davenport Association of Credit Men in a contest conducted by the National Association of Credit Men in 1915.

Please note if NAME, BUSINESS and ADDRESS correspond with your inquiry.

Smith DRY GOODS CO.
RETAIL Newark, Ohio.
100 Main St.

Jos. Smith, Pres.
Percy E. Smith, Vice-Pres.
Thos. Jones, Sec.
Arthur J. Smith, Treas.

July 13, 1916

Record

This company was incorporated under the general laws of the State of Ohio with an authorized capital stock of \$70,000 divided into shares of par value \$100 each. The business was originally established here some years ago by Jos. Smith, Sr., but about 5 years ago disposed of the business to his sons, Percy E. & Arthur J. Smith, who gave their notes for the greater portion of the purchase price. The above company was subsequently incorporated and the above officers elected. The business has all along been operated with fair success, and under capable management. The interested parties are well spoken of in all respects, are industrious and give their business close attention.

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Statements

The following comparative statements have been received from them:

Dates	Assets	Liabilities	Surplus
Dec. 1911.....	\$82,738.94	\$37,477.86	\$45,261.08
Apr. 1913.....	73,818.02	22,445.85	51,372.17
May 1914.....	69,283.60	40,465.97	28,817.63
Dec. 1914.....	60,270.66	41,495.56	18,777.66
Dec. 1915.....	43,304.80	29,995.11	24,336.15

Under the signature of P. E. Smith the following signed statement is now received purporting to be from inventory of May 31, 1916:

Quick Assets

Cash	\$ 654.40
Bills receivable	40.11
Accounts receivable	5,001.65
Merchandise	38,494.17
	<hr/> \$44,190.33

Liabilities

Commercial & Savings Bank...	\$ 2,500.00
Manufacturers National Bank..	10,400.00
Mrs. Smith	5,000.00
Others	10,407.40
	<hr/> \$28,307.40

Working capital\$15,882.73

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Miscellaneous Assets

Furniture	\$ 7,923.86
Percy Smith	2,192.53
Doubtful Accounts	817.33
	<hr/> \$10,933.72

Net worth\$26,816.45
 (Signed) Smith Dry Goods Co.
 Per P. E. Smith.

General Information

They have reduced their operating expense to a minimum and by careful and conservative management have succeeded into working their affairs into a better shape. A comparison of the statement December 31, 1914, with statement of May 31, 1916, would indicate a decrease in quick assets of approximately \$2,600. Their indebtedness has since been reduced from \$41,493.56 to \$28,307.40. That working capital having been increased during that period from \$7,309.16 to \$15,882.73. A comparison of their statement show a steady gain and improvement in their affairs since 1914. They claim in a communication in connection with the statement that merchandise investment is an estimated figure based on percentage of cost. While the bank indebtedness has not during the past 2 years been reduced according to their statement their merchandise indebtedness has been reduced by \$12,000. But it is learned that since May 31, 1916, they have wiped out the indebtedness of the Commercial & Savings Bank. The statement as submitted is identical with one furnished to local bank and believed conservative. They have a very fair investment of stock on hand and have something in accounts re-

ceivable. Their store is equipped with modern and up-to-date fixtures. While they no doubt represent a fair equity in the business in view of their heavy indebtedness to banks and otherwise, it is not deemed practical to assign a capital rating.

The company is at this time said to be doing a large and increasing business, which is under very capable management, and with the improving business conditions locally their future prospects are favorably commented upon.

Trade Opinions

The company have all along been quoted meeting obligations in a prompt manner. An investigation made among ten houses in August, 1915, all quote the account as prompt. The following is the result of a trade investigation made at this time.

1. Have been selling this account for a number of years, extending credit up to \$1,000 on regular term; discounts are availed of and now has only current purchases not due.

2. Have sold for the past five years on regular terms; highest credit \$1,000 is now owing but not due, bills are discounted.

3. Have sold for several years, purchases ranging from \$500 to \$700, and bills usually discounted or met at maturity.

4. Have sold for the past three years, highest credit \$450; 70 day terms, and accounts are availed of, owes nothing at the present time.

5. Have been selling for several years, highest credit \$200 regular terms, and bills are usually discounted or met at maturity. Owes current purchases not due.

6. Opened account in Spring 1916 extending credit

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up to \$50 2% 10-30 day terms, no balance at present time. Other houses consulted report having no credit experience with the account.

7. Sold recently highest credit \$490; regular terms, owing nothing at present.

8. Very small bill discount.

9. We are not selling.

10. Have sold for years, highest credit \$280 terms 70 days; payments have been made promptly; nothing owing.

11. Have had this account several years, previous to this highest credit \$70 regular terms, discount in 10 days, nothing owing.

12. Have had this account for 1 year. Highest credit \$70 goods sold on 6-10-60 bills discounted, owes nothing at present, account considered satisfactory.

13. Sold this account for years, highest credit \$175, goods sold on 7-10-60 bills discounted, owes \$15 not yet due, account satisfactory.

14. Have had one transaction, highest credit \$205, sold on 60 days bills discounted; owes nothing at present, account satisfactory.

15. Sold this account since 1913, highest credit \$290. Goods sold on 2% 10-60 paid at maturity. Nothing owing at present, regard account satisfactory, account is limited to \$300.

16. Refuse to sell at present except on a cash basis.

17.

Acct.	H. C.	Terms	Owing	Remarks
Old	\$300	2-10-60	\$300	Prompt
"	300	2-10-60	100	"
"	300	2-10-60	0	"
"	400	2-10-60	200	Prompt to one week over
"	100	70 days	0	Prompt

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Old	\$600	70 days	o	Prompt
"	900	70 days	500	"
"	400	7-10-60	15	"
"	200	7-10-60	o	"
"	150	2-10-60	o	"
"	200	60 days	100	"
"	75	Regular	40	Prompt prior to their difficulties. Sold them up to \$400
New	50	30 days	o	Discount sold since Feb. 1914
Old	25	10 & 30 days	o	Discount and prompt
"	250	Regular	o	Prompt, have not sold this year
"	500	70 days	o	Prompt

17. Received small order, but did not ship.

18. Old account sell in a moderate way on regular terms, payments prompt. Three report no transactions, within the past year, thirty others consulted claim, no experience.

NO FIRE RECORD.

N. Y. 12-5-1916. CR

- - to -3

BROWN AND TRACY
JOB, COTTON AND WOOLEN GOODS
N. Y. CITY

Abraham Brown
Jacob Tracy

Jan. 20, 1908.—117 Eldridge St.

The partners are both married men aged about forty-two years, and have been in business under

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above style since August 1, 1900, they having originally been located at 70 Eldridge St., afterwards removing to 71 Eldridge St., and returned to first written address May 1, 1906.

Since having been in business they made statements which are summarized as follows:

Date	Assets	Liabilities	Surplus
Aug. 1, 1901	\$ 7,600.00	\$ 800.00	\$ 6,800.00
Jan. 1902	10,070.00	1,500.00	8,570.00
Aug. 1902	15,000.00	2,500.00	12,500.00
Dec. 1902	17,700.00	3,700.00	14,000.00
June 1903	24,500.00	7,500.00	17,000.00
Dec. 1903	27,500.00	7,500.00	20,000.00
Aug. 15, 1904	33,000.00	7,000.00	26,000.00
Dec. 1904	40,000.00	10,000.00	30,000.00
July 1, 1905	51,000.00	16,000.00	35,000.00
Jan. 8, 1906	68,000.00	18,000.00	58,000.00
Feb. 16, 1906	68,526.75	18,104.50	50,422.25
Aug. 12, 1906	64,875.03	15,125.50	49,749.73
Dec. 15, 1906	75,356.49	24,135.55	51,220.94

Under date of the 11th instant and as taken from inventory of December 28, 1907, the following statement signed by Jacob Tracy has been submitted:

Assets

Merchandise on hand, cost.....	\$38,415.40
Outstanding accounts, new.....	31,250.55
Machinery and fixtures.....	975.00
Cash on hand.....	820.00
Cash in bank.....	5,696.43
Total available assets.....	\$77,157.38

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Liabilities

For merchandise on hand.....	\$16,312.30	
Loans from bank.....	11,212.55	
		<hr/> 27,524.95
Surplus in business.....	\$49,632.43	

Real Estate

70 Eldridge St. (Firm Name)		
valued	\$22,000.00	
Mortgaged	17,000.00	
		<hr/>
Equity	5,000.00	
		<hr/>
Total worth in and out of business.....	\$54,632.43	

Keep a set of books; do not borrow on accounts receivable; never had a fire. Insurance on stock, \$28,500; annual rent, \$1,500; annual business amounts to \$261,000.

The present figures compared with those of December, 1906, showed that they have not much more than held their own. The account is known to prominent houses several of whom were interviewed recently report selling them on 10-60, amounts running around \$1,000 or so and their obligations have been promptly met.

H. A. K.

(E 2½)

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BROWN AND TRACY
JOB, COTTON AND WOOLEN GDS.

N. Y. City

Aug. 3, 1908.—117 Eldridge St.

Those consulted are of the opinion that this firm have not much more than held its own since the early part of the year.

The account has long been known to prominent houses who have been selling it right along on ten sixty basis amounts running up to a couple of thousand dollars or so in some quarters and payments among those consulted are reported satisfactory.

(E 2½)

H. A. K.

Sept. 2d, 1908

MODEL AGENCY REPORT

Brown, Wm. T.

GROCERY

Davenport, Iowa,
Scott County,
123 New Street.

7/15/14,

Wm. T. Brown, 26, Single.

(1) *Antecedents*

Mr. Brown began work at the age of 19 for N. G. Smith and clerked in his grocery store for seven years. This is his first experience in business.

(2) *Statement*

Under date of July 15, he gave our representative the following signed statement as showing his financial condition at this time:

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Assets:

Stock on hand.....	\$1,700.00
Store furniture and fixtures....	400.00
Cash on hand and in bank.....	200.00
Accts. receivable	600.00

Total Assets\$2,900.00

Liabilities:

Mdse, open account not due...	\$300.00
No other indebtedness.	
Insurance on stock.....	\$ 1,400.00
Monthly store rent.....	35.00
Monthly wages paid.....	125.00
Annual Sales	18,000.00
No liability as bondsman or endorser.	

(3) *List of Wholesalers*

Buys from the following:

Halligan Coffee Company, Davenport, Iowa.
J. F. Kelly Company, Davenport, Iowa.
Morton L. Marks Company, Davenport, Iowa.
Van Patten Sons Company, Davenport, Iowa.
Smith Brothers & Burdick, Davenport, Iowa.
G. S. Johnson & Company, Davenport, Iowa.

(4) *Bank*

Banks with the Home Savings Bank.

Signed by
Wm. T. Brown.

(5) *Investigation*

Mr. Brown is a young man of good business ability and of the best of habits and character. He claims to

have saved the money with which he went in business from his salary. His store is fairly well located and is kept in good condition. Mr. Brown, with his sister, does all the work. He is stretching his capital somewhat in order to carry the stock necessary, and this at times makes him a few days slow in paying his bills. The account is well thought of among the wholesale trade and, as a rule, the bills are met when due. The general opinion is that the statement as given is about right. He is said to be a hard worker and pays close attention to the business.

(6)

Trade Experience

- No. 1. We have sold him ever since he started. Highest credit \$40.00. He owes nothing at this time. Pays in 30 days.
- No. 2. We have sold him since last fall. Highest credit \$92.00. He owes at this time \$82.00, of which \$60.00 is just due. He usually pays in 30 days, but has run a few days past due a few times.
- No. 3. We sell him quite a few goods on 30 and 60 days' terms. His highest credit \$200.00. He owes at this time \$100.00 not yet due. He pays us when due. The account is satisfactory.
- No. 4. His highest credit with us is \$65.00. He owes at this time \$36.00. He does not discount, but pays when due. Our terms are 60 days net.

(7)

Fire Record

Never burned out or suffered loss by fire.

(8)

Rating Assigned

(Whatever symbols are used
.....by the Agency reporting.)

Accompanying the report is the following explanation:

Attached is what we consider a model mercantile report.

The first requisite of a statement is legibility and accuracy, including the absence of typographical errors. The various headings should appear in the order of their importance.

No. 1.—The first is Character, Habits and Antecedents. A man's financial statement may be satisfactory, but if his character is unreliable and his habits are not good and his former record is not clean, he can hardly be considered a good credit risk.

No. 2.—The next in importance is the Signed Financial Statement showing a complete list of assets and liabilities, subdivided, of course, according to the nature of the business the party under investigation is engaged in. A corporation, manufacturing concern or a large firm should necessarily show greater detail in its financial statement than a small retail dealer. The nature of the detail will of course depend upon the particular business. The report should state whether or not the statement was actually signed by the party and should in all cases include insurance carried on store building if owned by the dealer and on stock, also the monthly store rent when the store

building is not owned, monthly wages and salaries, annual sales and also liability as endorser or bondsman. If a dealer carries too small an amount of insurance in proportion to his stock of merchandise he is either placing the valuation on his stock too high or he is not careful to safeguard his business by carrying adequate protection. If his monthly store rent is too high and his monthly expenses for wages are too high for the amount of business done, that would be a danger-signal suggesting care in extending credit. Liability as a bondsman or endorser is a very important point and its bearing on the advisability of extending or restricting credit can only be determined by specially investigating each individual case.

No. 3.—The next in order should be a list of the dealers from whom the party under investigation is purchasing his merchandise because, having a list of those, further investigation can be made by a member using an inquiry blank of the National Association of Credit Men, which sometimes discloses some of the most valuable information regarding the credit risk.

No. 4.—The next in order should be the bank with whom the party under investigation does business, although the information imparted by a bank as a rule is not as definite nor as valuable as that obtained from merchandise creditors.

It is important that the statement be signed because it will only be a few years until every state will have the uniform false statement law.

No. 5.—Next in order we would place investigation

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of verification of the statement made by the party under investigation and information of a general character as to the condition of stock, location and the opinions of various authorities consulted.

No. 6.—Trade reports from as many sources and as explicitly as possible.

No. 7.—Fire record.

No. 8.—Rating assigned.

(Whatever symbols are used
.....by the Agency reporting.)

SPECIAL AGENCIES

Constantly improving, the effective services rendered by the large mercantile agencies induced the free imparting of knowledge pertaining to credit. This exchange of confidences contributed, as we have seen, to the elevation of commerce to a higher plane, supplanting, for the petty jealousies, a friendly, though vigorous rivalry among merchants. It was not a small factor in the progress towards enlightened co-operation.

The general agency to-day involves a very heavy investment and is so organized that there is practically no limit to its activities, which extend almost over the entire civilized world. However, in the very vastness of this wonderful machine are to be found its weaknesses.

Organized to cope with work on a large scale, the engine is not built for speed. It is the aim of the

agency to anticipate inquiries, and they do have reports concerning most debtors on file. These obviously cannot be had in all cases. Furthermore, credit men are continually wanting special information regarding newly created conditions. The big agencies cannot furnish such reports without delay, nor are they organized to report up-to-the-minute detailed ledger facts. The large agencies cannot revise their reports very often for two reasons; first, on account of the expense involved, for it must be borne in mind that the profits of the large agency come from the sale of one report several times, and, second, because it would be unwise for the agency to pry into a merchant's affairs too often, unless there were some serious development, for to do so would arouse the antagonism of merchants generally.

Taking advantage of these conditions, smaller agencies have come into the field, organized to render special services. Usually the feature of their reports is the citing of a number of ledger facts; and many credit men believe that no more valuable information is obtainable than that contained in the ledgers of the merchant's creditors. Lacking the equipment of the larger agency, the special agency is more restricted in its scope, but by specializing on a few lines of industry, and by operating over more limited territory, it is in a position to give very useful information.

The special agency usually does not visit the merchant to be reported upon, but obtains the major part of its information from credit men of houses dealing with the merchant. Statements, when given in the

special agency's report, are generally obtained from the merchant by correspondence, unless the merchant is located in the city in which the agency operates.

Special agencies have usually been established and promoted by men who have had previous experience either with the older agencies or as credit managers. These agencies vary in magnitude from the individual, who makes personal investigations at so much per report, to companies organized on a fairly large scale. They are prepared to make immediate investigations, visiting banks, as well as wholesalers and manufacturers, to ascertain their experiences and views concerning the subject of the inquiry. Thus we find reporters of these agencies circulating among merchants who cater to buyers of boots and shoes, millinery, notions, woolens and worsteds, dry goods, etc. The investigator works among the same credit men daily and becomes a specialist in his particular line. He knows from experience where the applicant for credit is likely to be known. Primarily the special agency reporter is interested in the ledger information, although very often he obtains valuable facts relative to the record or general standing of the debtor.

Some of these special agencies, by giving the sources of the information, afford the credit man the opportunity of distinguishing between the opinions expressed by the conservative and the more liberal credit grantors. Moreover, this kind of a report enables the credit man to make further direct inquiries at the houses whose names are mentioned in the report. Of course, the special agencies which disclose this infor-

mation must discriminate carefully in selecting clients, for the information furnished is of a highly confidential character.

SPECIMEN REPORT OF SPECIAL AGENCY

Report on Brown and Tracy (Job. Cotton and Woolen Goods)

William Eaton, Cotton House. We have sold some time, account gets up to \$1,500 on ten sixty, and they are prompt.

John Ebbetts, Commission House. We have been selling some time, account gets up to \$1,000 on ten sixty, and they have been prompt to a few days over; account is satisfactory to us.

E. Hunt, Specialty House. We have sold some time, account getting up to \$500. On ten sixty and they run a little over, but this is satisfactory to us.

P. Miller, Lace Goods. We have sold some time, account getting up to \$300 on ten sixty, and they run about thirty days over.

J. Woodside, Cottons. We have been selling some time, account getting up to \$1,000 on ten sixty, and they are prompt.

J. Luce, Cottons. We have been selling some time, and the account is very satisfactory to us, getting up to \$1,200 at a time on ten thirty, and all bills have been paid promptly.

Quick Bros., Commission House. We never cared to sell.

A. Samson, Commission House. We have sold some time; in the past the account has been up to

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\$1,000, but of late not over \$200 on ten sixty, and they have been paying us on statement.

L. Todd, Cotton Goods. We have been selling some time, account getting up to \$400 on ten sixty, and they run a week over.

CHAPTER VIII

SOURCES OF INFORMATION (*Continued*)

THE CREDIT EXCHANGE BUREAU

The interchange of ledger experience by credit men has stimulated a sincere co-operative spirit among merchants. Sellers generally rely to a very large degree upon the experiences of other merchants when determining whether or not to grant credit to any applicant. They are justified in so doing, for the judgment of a merchant's creditors as to his credit worth is usually a most satisfactory criterion of his true standing.

To facilitate the exchange of credit information among credit grantors, credit exchange bureaus have been organized. These bureaus have been established by a number of the local credit men's associations and, in the larger cities, by various trade associations.

TWO SYSTEMS

The methods employed by these bureaus vary to a great degree. In general, however, they may be divided into two distinct groups. The members of the credit bureau send their inquiries to a central office established by the bureau and usually under the super-

vision of a salaried secretary. Upon receipt of the inquiry the bureaus operating under one plan will investigate the subject of the inquiry among the houses known to have had dealings with him, while the bureaus operating under a second plan will merely give the inquiring member the names of these houses so that the member may investigate and obtain the information directly from those houses.

The operation of the latter class of credit exchange bureaus may be described briefly as follows: Each member is first given a distinctive number, for example, Jones Manufacturing Co. is given number 1, Smith Wholesale Co., number 2, Walters Jobbing Company, number 3, and so on. A list of the members with their distinctive numbers is printed and distributed to all members, so that each may know the identifying number of each of the others. Each member then sends to the central office a list of all of his customers. A card is then made out for each customer and on this card is put the numbers of all members having dealings with the customer; for example, if Richard Roe, a retailer, were a customer of both the Jones Manufacturing Company and the Walters Jobbing Company, Roe's card would bear the numbers 1 and 3.

When a member desires to make a credit inquiry concerning a new customer, the member communicates with the central office, either by telephone or by sending the inquiry on a blank furnished for the purpose. The central office, after consulting the customer's card, advises the member of the numbers of all members having dealings with the subject of the in-

quiry. At the same time, the central office adds the number of the inquiring member to the customer's card, so that the file is kept up to date.

Upon receiving the information above, the inquiring member, by consulting his key list, ascertains the names of the houses, and has his credit department investigator visit these houses. The investigator then obtains the information desired by the credit department. What information he seeks is discussed in a succeeding chapter. Instead of sending around an investigator, the credit man sometimes uses the telephone.

A COMPLETE REPORT SYSTEM

The second class of credit exchange bureaus conducts its operations somewhat similarly to the one above described. It differs, however, in that it goes a step further and furnishes written reports instead of merely giving the names of members of the houses having business dealings with the subject of the inquiry. Like the bureau first described, each member is given a number, the names are listed, and each member furnishes a list of his customers. When a member desires to make an inquiry on a new customer, he uses a blank supplied by the bureau. These inquiry blanks are sent to the central office, which assembles them and, under one system, makes up for each member a special list containing the names of his customers about whom inquiries have been made that day. The member then indicates by symbol or otherwise his experience with the customers. Under another system, the central office lists all customers, who were

THE WHOLESALE SHOE LEAGUE

DATE..... SUBSCRIBER'S NO.....

Please fill out information blanks on following if interested, ever interested or declined. Draw a line through unanswered names.

NAME

ADDRESS

List of Subjects of Inquiry, copy of which is sent to all members.

the subject of inquiry that morning, on a special sheet. A copy of this sheet is then sent to each member, who comments on his experiences with those of his customers on the list.

INFORMATION EXCHANGED BY MEMBERS

The information called for on these sheets or on separate information blanks includes, usually, the following:

(a) Amount owing. That is, the amount the customer owes to the member. This is important for it is a sign of the extent to which other houses are giving the customer credit. It also enables the credit man partially to check up the item "accounts payable"

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in his customer's statement. It further indicates whether or not the customer is overbuying.

(b) Amount overdue. This, together with (c), points out the manner in which the customer meets his obligations and is an indication of the customer's present condition.

(c) Manner of payment. The credit man is intensely interested in the manner in which a new credit applicant pays his debts elsewhere, for the credit man does not care to take on accounts which are "slow pay" and difficult to collect. The credit man is also interested in knowing how his customers are paying other creditors, for this information is quite important when granting additional credit or when collecting the account.

(d) Last order. This information assists the credit man in determining the value of the items above, for if the house giving the information has had no recent dealings with the customer, its opinion must be discounted.

(e) Remarks. This gives the member an opportunity to put any special information on the sheet.

CLEARING THE INFORMATION

After the sheets are filled out by the members they are returned, usually by messenger, to the central office, which "clears" the information contained on the sheets. That is, the different information on a single customer is compiled in a report, which is then sent to the member making the inquiry or, in some cases, to every member of the bureau.

THE WHOLESALE SHOE LEAGUE,**127 DUANE STREET, NEW YORK, N. Y.****Telephone, Worth 1348**

INFORMATION BLANK

Member's No. _____ N. Y., _____ 191 _____

Name _____

Address _____

- 1 If new account,
amount of first order _____
 - 2 How long sold _____
 - 3 Highest credit _____
 - 4 Now owes _____
 - 5 Past due _____
 - 6 How pays _____
 - 7 Is account secured _____
 - 8 Are unfilled orders
larger than usual _____
 - 9 Date of last payment _____
 - 10 Amount of last payment _____
 - 11 Sell for cash _____
- Remarks _____
-

Please have answer blanks ready for messenger at 12 o'clock, otherwise information desired cannot be furnished on the same day.

N. B.—If information on question No. 8 is particularly desired, state so on inquiry blank, otherwise it will remain unanswered.

OTHER INFORMATION DESIRABLE

Some credit interchange bureaus make a point of ascertaining, in addition to the information above, the amount of new credit a customer is seeking among its members. This is extremely important, for whenever a merchant sets out to defraud his creditors he will usually establish himself in the confidence of a few of his creditors and then attempt to buy as freely as sellers will permit. This he accomplishes either by opening a number of new purchasing accounts or by extending his credit line with his old creditors. The information gathered by a credit exchange bureau, that a customer is opening a number of new accounts, is a danger signal to the credit man.

OBJECTIONS TO CREDIT EXCHANGE BUREAUS

One of the possible dangers of using the credit exchange bureau system, where complete reports are rendered by the bureau, is that members might be induced to substitute the service of the bureau for personal interchange between members. On this point we quote from the 1915 report of the Committee on Credit Co-operation of the National Association of Credit Men:

"Your committee wishes to utter a word of warning against a tendency that has appeared to substitute the service of credit interchange bureaus for direct interchange between members of the Association. The real purpose for which credit interchange bureaus are organized and operated—that is, economy and com-

THE WHOLESALE SHOE LEAGUE

Name.....Date.....

Address.....

1	2	3	4	5	6	7	8	9	10
If new acct., amount of first order	How long sold	Highest credit	Now owes	Past due	How pays	Account secured	Unfilled orders larger than usual	Date of last payment	Amount of last payment

pleteness in clearances—was not intended as a substitute for the direct and personal relation between members of the Association in credit experience interchange, and rather than detract or diminish this direct relationship, what the bureaus have done and can accomplish, should more deeply suggest and defend the direct and personal interchange. In brief, the credit interchange bureaus are intended as a supplement, not a substitute, for the direct interchange.”

Under the system first described no such danger exists.

It is obvious, too, that the value of the reports furnished by the credit interchange bureau depends to a large degree upon the number of its members. To reach its maximum efficiency the bureau should include in its membership all of the possible creditors of a single customer, for only in this way can the credit man know of the experiences of a customer with all his creditors. This state of efficiency has seldom, if ever, been reached, although it is the goal to which credit bureaus constantly strive. However, the farther separated from this ideal bureau the actual bureau is, the less valuable its reports become.

On the other hand, many credit men object to belonging to credit exchange bureaus, because it imposes on them the obligation of answering every inquiry made concerning their customers. This, many credit men believe, is frequently unfair for the reason that they may be compelled to answer several times as many inquiries as they make. Then, too, some credit men fear they may be required, at times, to answer an inquiry upon a customer whose condition

may be temporarily strained, and whose account needs very delicate treatment. By disclosing the customer's predicament, those credit men are of the opinion that the condition of the customer may be so weakened as to wreck him with a resulting loss to all creditors. In answer to this objection, there is no obligation on the part of members to disclose their customer's position indiscriminately to all members, and it is quite possible judiciously to give the information called for to those members making the inquiry without the bad results pictured. On the contrary true interchange relations should inspire action in concert to tide the weakened debtor over his difficulties and thus serve the best interests of all concerned.

THE CREDIT CLEARING HOUSE

Practically all of these bureaus are local in nature. Recently, however, a movement has been started to establish a national credit interchange bureau under the jurisdiction of the National Association of Credit Men.¹ At the present time the Credit Clearing House is, as far as the writer knows, the only institution which attempts to clear information on a national basis.

In 1888, the Credit Clearing House undertook to act as a center for the assembling of ledger information and at this time (1916) its information covers 500,000 retail merchants.

Each member of the Credit Clearing House regis-

¹ See *Credit Men's Bulletin*, July, 1916, p. 524.

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ters the names of his customers, and contributes information whenever his customers are under consideration. In each case where his customers are concerned, he receives a copy of the information contributed by the other interested members.

The ledger facts relating to merchants are gathered from practically every important wholesale market in the country. Retail merchants are given an opportunity to submit their statements, so that the statement may be added to the report. Thorough investigation has shown that the paramount factor in such a report is the manner of payment, and so a convenient index to the manner of payment has been arrived at by using percentages.

If 25 houses report, and 10 say that payments are slow, a note at the foot of the report reads as follows:

Mar 1916 25 Payment Experiences 40% slow.

If earlier reports have been cleared, the earlier percentages are given. They reflect the tenor of the earlier reports, and show whether the merchant is doing better or worse. A typical example is that of a New York merchant who failed in July of 1915. In his case the percentages were:

Feb 1913	18	Payment Experiences	22% Slow
Jan 1914	20	"	35% Slow
Jan 1915	15	"	53% Slow
Mar 1915	19	"	79% Slow

The next important factor in such an exchange of information is its automatic disclosure of any attempt to buy more merchandise than usual, or to shift lia-

bilities to a new set of creditors. For convenience, the term "New Credit" is used in this connection and, if a merchant is seeking new credit to an extent that deserves notice, the percentage plan furnishes an additional remark at the foot of the report.

A typical case is that of a concern which failed in September, 1915:

Mar 1914	5	Payment Experiences	40%	Slow
Sep 1914	7	"	"	50% Slow
Feb 1915	8	"	"	78% Slow
May 1915	7	"	"	86% Slow

New Credit asked from 53%
of the houses reporting

The percentages should be accepted as a weather vane, that shows which way the wind blows but does not measure its violence. When the percentage is distinctly favorable, the credit man need not go further; when it is not distinctly favorable, he should examine the report itself.

When demands for new credit on the part of retail merchants are unusual, it is the custom of the Credit Clearing House to call special attention to them by issuing a notice to its members which suggests that the report should be consulted before credit is allowed. At the same time the merchant is given an opportunity to explain the reason for placing so many new orders, and the explanation, if pertinent, goes out with the notice. These notices have peculiar value. More than one thousand of them have been issued in the last five years, and it appears that more than 60% of the merchants in question ultimately fail.

FEATURES OF THE REPORT

In a general way, we may summarize the features of the report of the Credit Clearing House as follows:

The report sets out an impartial array of ledger facts and automatically brings to light favorable or unfavorable changes in the merchant's condition.

It sometimes gives timely warning of approaching failure.

The references are not chosen by the debtor.

The contents of the report are not disclosed to the debtor.

No member's name is disclosed even to another member without express permission.

The members specifically agree to substantiate each item if called upon to do so.

The membership embraces more than thirty lines of trade and covers the manufacturing section of the country fairly well.

A TYPICAL CREDIT CLEARING HOUSE REPORT

Smith & Bros. June 22, 1915 Somewhere So. Carolina

Cincinnati District

H't. Cr. Order Owing Due

	\$	\$	\$	\$		
C	736	0	736	400	slow	pays by notes; \$336 due
						June; terms dating;
						sold 1913 to 1914.

Baltimore District

C	1350	906	1200	1200	slow very	sold sev. seasons.
E	—	0	0	0	refused	\$263 Apr. 1915.

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New York District

E	o	110	o	o	first	order for shipment at once.
C	o	634	o	o	first	order for shipment Fall 1915.
C	136	o	o	o	slow 70	days; sold 1913 to date.
J	o	400	o	o	first	order for shipment Aug. 20.
dd	162	181	113	113	slow 60	days and pays; on acct.; Sep.; sold Sept., 1912, to date.

Philadelphia District

E	24	o	o	o	slow 30	days; pays dfts. when made; terms 90 & 60 x; sold yrs. to date.
C	o	320	o	o	first	order for shipment at once.
C	1000	o	325	325	slow	on acct. and pays by notes; Collecting by Att'y; due Sept., 1914; terms reg.; sold Spg. 1913 to Spg. 1914.

Southeastern District

E	96	o	96	39	slow	Collecting by Att'y; terms reg.; due Apr. to Aug.; sold since Oct. 9, 1914.
---	----	---	----	----	------	---

E New York District Coll. by Draft \$125 Nov. 14.

Comparing the reports in our file, we find the manner of payment as follows:

May	1913	9	Payment Experiences	33%	slow
Dec.	1913	14	"	50%	slow
Aug.	1914	12	"	58%	slow
Feb.	1915	9	"	100%	slow
June	1915	8	"	100%	slow

New Credit asked from 42% of the houses reporting.

Notice to inquire issued.

Sept. 1915. Bankruptcy.

DIRECT INTERCHANGE OF LEDGER EXPERIENCE

Ledger information relating to customers is frequently exchanged between creditors without the intervention of a credit bureau of any kind. This is accomplished through the agency of a credit department investigator (see page 146, *post*) or by correspondence. The question first to arise is, How does one creditor or prospective creditor ascertain who the other creditors of his customer are? This he does by asking the customer for references, that is the names of other creditors. The references furnished by the customer himself are apt to be valueless from the credit man's viewpoint, for the customer will select only those references who will speak well of him. As we shall see later, the credit man can obtain the names of other references through the offices of the traveling salesman. Then, too, where the credit man is a member of the credit exchange bureau first described, the obtaining of supplementary references is a simple matter. Moreover the character of the customer's business usually suggests to the credit man names of other selling houses to whom the debtor is probably known.

FORMS USED FOR DIRECT INTERCHANGE

To facilitate the direct interchange of ledger experience, the National Association of Credit Men has adopted the special form found on the following page.

Attached to the form given on the following page is a duplicate sheet containing the same matter as that found on the form given, except for the words, "Re-

RETURN THIS TO US

New York, N. Y. _____ 191

Kindly give us below YOUR EXPERIENCE with

Name _____

P. O. _____

ALL INFORMATION WILL BE CONSIDERED STRICTLY CONFIDENTIAL

Yours truly,

APPROVED AND ADOPTED BY NATIONAL ASSOCIATION OF CREDIT MEN

RICHMAN & CO.
 Members National Association
 of Credit Men

To _____

		MANNER OF PAYMENT
Sold Since _____		
Terms _____		<i>Discounts</i>
Highest Recent Credit \$ _____		<i>Prompt and satisfactory</i>
Owing Now { On Open Account, \$ _____		<i>Slow but considered good</i>
{ On Notes, . . . \$ _____		<i>Slow and unsatisfactory</i>
Past Due { On Open Account, \$ _____		<i>Pays C. O. D.</i>
{ On Notes, . . . \$ _____		<i>Sell for cash only</i>
First Order, \$ _____		<i>Account secured</i>
Other Information _____		<i>Notes secured</i>
_____		<i>Account closed for cause</i>
_____		<i>Makes unjust claims</i>
_____		<i>Collected by attorney</i>

Form Used For Direct Interchange

turn this to us. Kindly give us *Your Experience*" are substituted the words, "Retain this for your files. We give you below *Our Experience*." This sheet is filled out by the inquiring house, in compliance with rule 4 given below. This rule and a number of others have been adopted by the National Association of Credit Men to prevent abuse of the system and to encourage reciprocity in the exchange of information. These rules ¹ are printed on the back of the forms and are as follows:

1. The blank approved and adopted by the National Association of Credit Men for the making of inquiries shall be used.
2. The blank shall always indicate the nature of the business in which the subject of inquiry is engaged.
3. Each inquiry shall state the amount of the order which leads to making the inquiry and in addition indicate if it is a first order.
4. If the inquirer has had previous experience with the one inquired on, then the inquiry shall be accompanied by a statement of such experience, thus encouraging that reciprocal interchange of experience without which the inquiry becomes unfair.
5. Inquiries are not to be made except on orders actually in hand or on open account. If investigation is being made with a view to

¹ Rules to Govern the Interchange of Credit Experience
Between Members,

As revised to meet certain evils in the exchange of credit information emphasized by the Credit Cooperation Committee at the convention of the Association, June, 1914.

soliciting business or collecting an account, a letter explicitly stating this fact shall accompany the inquiry.

6. Inquiries shall only be made through properly constituted credit departments; inquiries by salesmen shall not be permitted.
7. It is essential that there shall be no promiscuous inquiries sent out with the idea of determining what concerns have had experience with the subject of inquiry, for promiscuous inquiries may do harm to the customer and impose unnecessary burdens upon credit departments.
8. All inquiries are to be answered on the day received and by the credit man or manager if possible, so that not only ledger experience may be supplied, but any additional valuable information in the possession of the informant.

CONCLUSION

A compliance with these rules in making inquiries will bring about genuine interchange of credit information and lead to accuracy, reciprocation, promptness and confidence. Their observance will mean a closer contact between the members of the National Association of Credit Men and be of great assistance in their credit investigations.

These forms or modifications of them are quite generally used in the interchange of ledger information. Where, however, the inquiry is of an unusual kind it will be found better to write a letter stating exactly what information is desired.

THE CREDIT DEPARTMENT INVESTIGATOR

Encouraged by the success of the system of free interchange of credit information, a number of houses, especially the larger ones, make it a practice of obtaining the credit experiences and opinions of other creditors through personal investigations made by a member of the credit department. This investigator visits those mercantile houses and banks to whom he thinks the applicant for credit may be known. When it is thought desirable, the investigator even calls upon rival competitive concerns.

Necessarily the investigator confines his inquiries to local concerns and banks. He usually carries with him a list of those credit seekers he desires to investigate during the day. He goes over the list with the credit man at each concern visited, ascertains which accounts are known and seeks to obtain the following information:

- (1) How long the account is known.
- (2) The highest amount of credit extended to it.
- (3) The present indebtedness.
- (4) Manner of payments.
- (5) Present status of the account.
- (6) Opinion of the creditor as to the quality of the account.

While the above is the ground usually covered by the special agencies and credit exchange bureaus, this direct method of obtaining information has many important advantages. Foremost among these advantages is the quick action this investigation induces. The value of celerity in getting information is ap-

parent to the credit man who has found by experience that delays in passing upon the credit while waiting for agency reports sometimes cause the cancellation of an order which, on the basis of reports subsequently obtained, could safely have been approved.

In the second place, the oral investigation brings the information up to date. This enables the credit man in considering the case of a doubtful account to ascertain how current payments are being made elsewhere, as well as the consensus of other creditors' opinions at that particular time. And this is especially important, for waning confidence aggravates a doubtful risk. In the third place, a superior quality of information is often so obtained. For example, information which discretion would forbid communicating to agencies for general circulation is often given verbally to a personal representative of the credit man of a reputable house.

OBJECTIONS TO ORAL INVESTIGATIONS

This system of oral investigations, which usually produces more prompt, fresh and valuable information, is not without its abuses. For instance, multiplicity of investigations, particularly when the financial condition of the subject of the inquiries is not too strong, may cause an undue disturbance in the minds of those credit men receiving the inquiries, and this is quite likely to entail injurious consequences to the debtor. Moreover the busy credit man, without appreciating the compliment, is sometimes imposed upon by wholesale inquiries from credit departments of

other concerns which prefer to be guided by his judgment rather than by their own. Then too, indiscriminate investigations are made by some credit departments when considering, not an existing account, but a prospective customer. Such inquiries are entirely unnecessary, for the facilities of the various agencies are adequate to serve this purpose.

THE EQUIPMENT OF THE INVESTIGATOR

In a final analysis, however, the real value of orally gathered information depends largely upon the personality and equipment of the investigator. Results will usually be commensurate with his efficiency. When he first appears at the credit office of concerns he calls upon, he is received as a representative of his house, but as his visits continue he is treated on his own merits. The incompetent, untrained young man, incapable of drawing obvious conclusions, will ask questions already answered by the facts given, and in a routine way drag the interview regardless of how busy he may find the credit man upon whom he calls. Such tactics will hardly induce a discussion of the account beyond the giving of the usual stereotyped facts.

Quite different are the tactics employed and the results obtained by the qualified investigator. He familiarizes himself with the status of the account as much as possible before he starts out. He knows what he is after, how to get it and when he has got it. The experienced investigator is trained properly to interpret the information obtained from the credit men he

sees. He is alert and quick to grasp the significance of facts. Although he is very careful to be brief, he will, when the occasion seems to require it, intelligently and tactfully ask questions which often yield fruitful replies. In a conversation of this kind, he will occasionally impart information hitherto unknown to the credit man he visits. These "tips" are valued. However, the giving of them is a delicate matter. The investigator must not leave the impression that he is "gossipy." Obviously credit men will relate confidential facts, which are always the most valuable, only to an investigator who can be trusted to use them discriminately.

The above observations, concerning the required personal qualifications of the investigator, make it evident that investigating affords excellent training to the credit assistant in preparation for his future work as credit man.

THE RECIPROCAL VALUE OF ORAL INVESTIGATIONS

With full confidence in the character of the investigator as a basis, the oral investigation facilitates reaching the highest point in the system of confidential interchange. The benefits are reciprocal, and immediately so. At the very moment the credit man of the concern visited is giving, he is also receiving information. A digression may be permitted here to direct the reader's attention to the practical fact that one of the most exacting requirements of a credit man, who is handling a large volume of business, is vigilant and close attention to the status of his accounts, not only

on his own books, but also in the market generally. It is, therefore, not only instructive, but also stimulating to the credit men visited to be constantly informed as to the names of those being investigated, and the reasons therefor, as well as to have these opportunities for the ready exchange of experiences and confidences. Thus, through this system of interchange, unfavorable information concerning a well regarded account is often brought to the credit man without any solicitation on his part. An unexpected development of this character serves as a signal of caution. Of still greater importance, however, is the effect of these interchanges in fostering co-operation among credit grantors, which in a broad sense is so essential to the effective regulation of credit. It can be readily understood, then, that the well trained investigator is welcomed by practically every credit man he visits.

CHAPTER IX

SOURCES OF INFORMATION (*Continued*)

THE RETAIL CREDIT EXCHANGE BUREAUS

Recognition of the value of the credit interchange bureaus has given rise to the organization of many retail credit exchange bureaus. The latter were practically unknown twenty years ago. At that time retail merchants, when extending credit, relied largely upon the outward appearance of the applicant and the meagre information available. Granting credit on this basis may have been satisfactory then, owing to the fact that communities were smaller, the consumers were better known, and by far the larger percentage of retail business was conducted on a cash basis. But with the growth of towns and cities, and with the great increase in the system of selling to consumers on credit, it became necessary to evolve a more scientific scheme for the basis of granting retail credits.

Applying the same principles of co-operation which the wholesale houses have found so valuable, the retail merchants organized credit exchange bureaus through which agency the merchants could exchange information relating to the credit standing of their customers. The methods employed in the operation of this bureau

are quite similar to the methods employed in the wholesale credit exchange bureaus. Usually, however, the retail bureaus do not confine themselves to the collection and dissemination of ledger facts, but gather all other relevant credit information which can be obtained relating to consumers in the community.

METHODS OF OPERATING

The detailed plans of operating these bureaus differ widely. A simple but typical plan may be described as follows: Each line of business is represented by a series of consecutive numbers, and each member of the association in the group is given an individual number; for example, butchers would have numbers 1-50, bakers, 50-100, grocers, 100-150, and so on; John Brown, a grocer, would be given number 107. Each member when he joins the association, sends in a list of names and addresses representing every account on his ledger and thereafter at regular intervals he turns in the names of new accounts opened, and old accounts closed, together with the reasons for closing the same. Some associations require the member to furnish complete data on the standing of his customers at the time of sending in the lists; others simply request the member to rate those names which he believes are not entitled to credit. A key is usually employed for the rating of customers.

Each customer is then given a separate "master" card, on which are entered the numbers of members with whom the customer deals and all other information relating to the customer. This other information

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includes the ratings and opinions given by members, and notices of mortgages, bankruptcy petitions, divorce and other suits clipped from the daily newspapers or gathered from other sources. Sometimes the bureau calls upon the consumer's employers for a record of his standing with them. Whenever the information is of such a character that it cannot be put upon the card, such as letters or lengthy written reports, the information is placed in another larger file and a reference made to it on the smaller cards. A specimen of one of these cards and of the key used by members is given below.

MASTER CARD						
Name.	Smith, John J.; married.					Family, 6
Res.	1417 Park Street					
Bus.	15 Broad St.; Bookkeeper, Brown Bros. Clothing Co.					
Date	9/16	9/17	9/24	10/3	11/6	12/4
Member's No.	47	4	127	32	143	159
Rating	PA	GB	C	P	N	N
<i>Remarks:</i> See File No. 1137. 10/26 CM on furniture purchased, \$175.						

RATING KEY	
C Pays Cash	V Pays very slow
P Pays prompt—bills less than \$5	K Account in collector's hands
Pa Pays prompt—bills for \$10	J Judgment taken
Pb Pays prompt—bills for \$25	CM Chattel mortgage
Pc Pays prompt bills for \$50	T Property attached
G Pays good, not prompt	N New account
S Pays slow	

When a member desires information about an account which is slow or a new account he is about to open he telephones to the bureau. A clerk in the bureau then reads to the inquiring member the information on file, and immediately thereafter the clerk attempts to gather the most recent information on the subject of the inquiry by telephoning to all members whose numbers appear on the consumer's card. When this recent information is compiled, the clerk again phones the inquiring member. In this connection, it is interesting to note that in many bureaus several of the members have direct telephone connections with the central office of the bureau.

INDEBTEDNESS REPORTS

The bureau also furnishes its members with reports showing the total indebtedness of a consumer. The knowledge that a consumer is overbuying and overextending his credit is of vital interest to the retailer, and the retail credit bureau is the only practical agent for gathering and supplying this knowledge. When a retailer desires to know how much one of his customers or prospective customers owes to other retailers, he simply gets in touch with the bureau. The credit bureau makes inquiry of each of the members who sell the consumer, and prepares a report of the information obtained. In many bureaus this report, a form of which is given below, is sent to all members dealing with the subject of the report. If the consumer is found to have overextended his credit, the

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retailers, either through the credit bureau or through a committee, see that the consumer liquidates his debts before any further credit is extended by any retailer.

When a new arrival takes up his residence in the community, and seeks to open charge accounts with various local retailers, his former address is obtained, and

REPORT ON CONSUMER'S INDEBTEDNESS						
<i>Name.</i>	Smith, John J.; Married. Family 6					
<i>Res.</i>	1417 Park Street					
<i>Bus.</i>	15 Broad Street; Bookkeeper, Brown Bros. Clothing Co.					
Member		Amount Owing	From	To	Amount Past Due	Rating
17	Grocer.....	\$ 12	12/16	1/17	\$ 10	Ga
329	Furniture...	175	10/26	1/17		P
						Install- ments (CM)
69	Butcher.....	16	11/16	1/17	8	Gb
	Total.....	\$203			\$ 18	
<i>Remarks:</i>						
10/26 CM on furniture purchased, \$175.						

the local credit exchange bureau attempts to get a report from the credit bureau of the city whence he came. This is possible, of course, only where such a bureau exists in the new applicant's former place of residence. With the increasing number of retail credit bureaus, it is anticipated that this practice will be encouraged.

ADDED FUNCTIONS OF THE BUREAU

Many retail credit bureaus have other functions in addition to those outlined above. Some, for example, send out notices to all interested members whenever any pertinent credit information concerning a consumer is obtained. Others publish daily or weekly bulletins, which contain mention of the following: all changes in residence of consumers; recent arrivals; removals; mortgages and deeds filed; warnings concerning fraudulent schemes being worked on retailers, and other special items of importance to all retailers. Some credit bureaus publish rating books in which are listed the names of all consumers in the community. Each name is given a rating, based on the information appearing on the "master" cards. The ratings in these books cannot always be relied upon, for they are necessarily at least six months behind the times. It requires practically this time to compile the information and publish the book. For this reason, many credit bureaus that formerly published these books have discontinued the practice.

CHAPTER X

SOURCES OF INFORMATION (*Continued*)

THE SALESMAN AS A SOURCE OF INFORMATION

Under present day methods of doing business, the salesman is frequently the only representative of his house who ever sees the customer personally. Moreover, in practice, he is usually the only person in his house who ever visits the customer at his place of business. It is quite apparent, then, that the salesman is in an excellent position to become acquainted with the business sagacity and local reputation of the customer, and thus furnish the credit department with particularly valuable information. For this reason, the salesman has frequently been considered one of the most important sources of credit information.

That the salesman is able to supply information is undisputed. Whether or not he will supply it and what the quality of the information will be, and how he may be encouraged to supply it are questions we shall presently consider.

INFORMATION OBTAINABLE BY SALESMAN

The salesman is "the man on the ground"; he sees the merchant at his store and is familiar with local

conditions. He is therefore able to furnish information regarding the merchant on the following points: (a) business ability, (b) habits, (c) local reputation, (d) location, (e) local conditions, (f) references, (g) financial status.

Business Ability. The salesman can quickly size up the condition of the merchant's stock. He knows at a glance whether the stock consists of a great deal of out-of-style merchandise which, if it ever sells, will move very slowly indeed. Then, too, by observing the prices at which merchandise is marked to sell, the salesman can tell whether the merchant is making a fair margin of profit or is cutting prices.

The salesman knows whether the merchant buys recklessly or prudently. He also knows that a careless buyer is usually a careless payer. Thus a merchant who overbuys, pays any price for his merchandise, or accepts any style or pattern, does so, probably, because he does not seriously consider his obligation to pay the bills when coming due. On the other hand, a discriminating buyer usually is earnestly concerned with his duty to meet his bills promptly.

The method of conducting business is another indication of business ability, and the failure or success of a merchant often depends upon the efficiency of his business organization and the manner in which his clerks wait upon customers. All of these things come within the salesman's observation. Whether a cash or credit business is being done can also be seen by the salesman.

Habits. Seldom is any one better qualified than the salesman to learn the habits of his customers. If he

gains their confidence, he will soon know whether they are addicted to excessive drinking, gambling or speculating. This information the credit department must have in order to pass intelligently on the credit risk involved.

Local reputation. The salesman is usually acquainted with other local merchants and other salesmen who visit the same customers, and from their remarks, the salesman may learn of the local reputation of the merchant. The salesman might even, when absolutely necessary, visit the local banks or attorneys and obtain their opinions.

Location. Where the customer is located in relation to the business center of a small city is an important feature for the credit man to consider when deciding, not only whether any credit is to be given, but also the quantity of credit to be extended. Likewise, whether or not a customer's place of business is very close to a competitive retail store is a factor to be taken into consideration by the credit man. For information on both of these conditions the credit man can rely on the salesman, for he can easily report on the location of customers when he visits them.

Local conditions. The credit department should know of those local conditions which affect the entire community and their customers' business in particular. For example, an important industry may remove or shut down or the local crop may fail, with a resulting decrease in the purchasing power of the community. Or possibly, the street on which the customer is located may be torn up, or transit facilities may be changed, turning the traffic and business to some other direc-

tion. The salesman is in a position to inform the credit department of these conditions.

References. As we have previously pointed out, the references furnished by a merchant himself are of little value, for he will be certain to give only the names of those houses where he pays his bills promptly; and it is always a comparatively easy matter to keep in good standing with three or four houses. The credit department would prefer to find out the names of the merchant's creditors from some other source. Here the credit man may turn to the salesman, who can readily obtain this information by noting the merchandise and boxes on the shelves of the merchant. Many credit men believe that in this respect the salesman is a most valuable adjunct to the credit department.

Financial Status. When he obtains first orders from small dealers the salesman can sometimes request a financial statement from the dealer to accompany the order and facilitate the checking of the order by the credit department.

From what has been said, the reader should not expect the salesman to constitute himself a detective but he has the right to expect the salesman to have his eyes and ears open at all times and to be on the alert for any pertinent information obtainable.

VALUE OF SALESMAN'S INFORMATION

The value of the information depends to a large extent upon the salesman himself, that is, upon how much of an authority he is on general conditions and

on business methods. A good part of the information the salesman furnishes is in the nature of opinions, and must be considered together with the knowledge and characteristics of the salesman. Then, too, one must bear in mind that many salesmen are prone to be rather over-optimistic and may permit their enthusiasm to becloud their judgment. On the other hand, many salesmen are keen judges of human nature and, knowing their territory thoroughly, can size up a situation splendidly.

SECURING THE CO-OPERATION OF THE SALESMAN

To what extent the salesman will furnish the information he can obtain and the quality of the information depend to a large degree upon the credit man. If he is broad minded and does his work with the idea of business promotion, if he treats customers considerately and thus helps the salesman retain the goodwill of his trade, if he gives proper consideration to suggestions offered by the salesman and when necessary goes over the rejected orders with the salesman, the credit man will soon enlist the active assistance of the salesman. Furthermore, by properly coaching and encouraging the salesman, the credit man can make him a valuable adjunct to the credit department.

A report filled out by the salesman should accompany all first orders. Forms used for this purpose are found below. In addition salesmen should, from time to time, advise the credit man of happenings involving the interests of their customers.

SALESMAN'S CREDIT REPORT

(This report must accompany all first orders)

NAME OF HOUSE

Dear Sirs:—

I submit the following information concerning:—

Name of Firm.....

(Give it exactly and spell it correctly)

Town..... County..... State.....

Full name of each partner Nationality Age Married

.....

.....

The firm has been in business since.....

formerly located at.....or clerked for.....

of.....or (here state other antecedents)

.....

Lines of merchandise carried.....

Estimate of present value of stock.....

Condition of stock.....

Is stock insured?.....How much?.....

City or country trade principally?.....

Credit or cash business?.....Good collector?.....

Location relative to business centre?.....

Local opinion as to habits?.....Ability?.....

Expenses?.....Is firm thought making money?.....

Is the firm, or any member of it, engaged or interested in other ventures?

Real estate in own name, if any, consists of.....

dwelling houses.....vacant lots.....

business stores valued at \$.....

and mortgaged for \$.....

Of this real estate the following is used as homestead.....

and valued at \$.....and mortgaged for \$.....

If they are just starting in business, what capital has the concern

SOURCES OF INFORMATION

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and in what shape? Cash \$. other assets \$.

Describe the other assets.

.

.

General local conditions affecting the business.

.

Buy principally from the following houses (give names and addresses)

.

.

.

Remarks

.

.

.

Salesman.

The above is a slight variation of a form recommended by the National Association of Credit Men. It is efficacious when applied to the smaller traders. However, the salesman, calling upon the larger merchants, could hardly be expected to make such detailed inquiry. Moreover, it will be remembered a good part of this information can be had from the agency. It must also be borne in mind that the salesman's principal duty is to sell goods, and he should not be expected to spend too much of his time gathering credit information which the credit man can easily obtain from other sources, for example, from the general agency reports. The salesman's report is intended merely as a supplement to, and a medium for checking up the agency report. The smaller the quantity of information the salesman is called upon to furnish, the better the information is likely to be. And

this is to be expected, for if the salesman is asked to fill out a very extensive blank form, he is inclined to guess at the answers. On the other hand, if he is requested to report on only a few important factors affecting his customers, he has some incentive to obtain more accurate and specific information. Therefore, it is usually better to have the salesman report only on those matters which come within his observation, and upon which he is peculiarly qualified to supply information.

It will be noticed that the foregoing report calls for much information that usually can be readily obtained through the general agencies. In most cases it would be better to eliminate the questions on those points. However, modifications of that report may be adopted to serve the special purpose of each house. In any event, the kind of report will depend to a large degree on the kind of business in which the selling house is engaged, the peculiar conditions surrounding the business, and the class of trade sold.

SHORT FORM OF REPORT

A simple form of report which covers information that can be obtained by the close observation of the salesman without causing any offense to his customers and without interfering in any way with his chief function of selling is given below. This form of report could well be used by many houses. Of course, the salesman should be coached and trained to fill in the reports properly.

NAME OF HOUSE

Name of firm.....
(Give it exactly and spell it correctly.)
Address
Business
Location relative to business centre.....
Condition of stock.....
Efficiency of organization.....
Competency of management.....
Local reputation.....
Local conditions affecting the business.....
Buy principally from.....
.....
.....
.....
Remarks
.....
.....

ATTORNEYS AS CREDIT REPORTERS

Another supplementary source of credit information is the attorney residing in the same town as the debtor. Like the salesman, the attorney sees the debtor at his place of business and is, therefore, in a position to furnish information concerning the local reputation of the debtor and local conditions affecting his standing.

INFORMATION OBTAINABLE BY ATTORNEY

In general, the information which is obtainable by an attorney is not unlike that furnished by the sales-

man. Thus we find attorneys reporting on the following factors affecting debtors:

- (a) Business ability.
- (b) Habits.
- (c) Local reputation.
- (d) Location.
- (e) Local conditions.
- (f) Value of real property and encumbrances thereon.
- (g) Claims and law suits.

Business Ability. It is undoubtedly true that the average lawyer is not a competent merchandising man and is therefore not qualified to give an expert opinion on the business ability of a merchant by observing the manner in which the merchant conducts his business. In this respect the average salesman is much better qualified. However, the average lawyer is probably able to recognize flagrant violations of sound merchandising principles and can report on obviously bad methods of doing business. Moreover, the attorney comes into contact with numerous other local merchants and from them he can easily obtain opinions as to the business ability of the subject of the inquiry.

Habits. In the smaller towns the local attorney is in a splendid position to give information on the habits of the local merchants. This is for the reason that the attorney is frequently acquainted with the personal and family history of local merchants from the time of their youth; and what the attorney does not know from this acquaintance, he knows from the gossip of other members of the community. Of course, in larger towns and cities, the attorney is not able to

obtain this information concerning the habits of merchants.

Local reputation. The attorney, especially in smaller communities, has a large circle of business and social acquaintances and friends from whom he can readily obtain opinions as to the standing of any local merchant.

Location and local conditions. The location of the merchant relative to the business centre of the community can easily be told by the local attorney. And, so too, any changes in local industries or traffic conditions that might affect the entire community or the merchant inquired about, come within the easy observation of the attorney.

Value of real property and encumbrances thereon. Valuing the real property of the local merchant is entirely a matter of opinion. Many attorneys are expert in this respect, and, in smaller communities, can often give an off-hand opinion of the value of property owned by the merchant that will approximate its actual value. This valuation the credit man can use as a check on the figures given by the large agencies or by the merchant in his own financial statement. However, the figures given by the attorney must always be considered in connection with the attorney's own reputation and the quality of other information furnished by him.

The encumbrances placed on the real property of the merchant are usually a matter of record and can be readily and accurately ascertained by the attorney by making a cursory search of the records.

Claims and law suits. The local attorney is in a

peculiar position to find out about the legal troubles besetting the local merchant. Frequently the attorney is called upon to represent other jobbing or selling houses in the collection of claims against the debtor in question. Furthermore, the attorney either has knowledge or has means of obtaining knowledge of law suits instituted by other attorneys, and of the progress and outcome of those suits.

QUALITY OF ATTORNEY'S REPORTS

Thus we find that the local attorney is situated so as to be able to furnish much valuable information to the credit man. This is true especially where the debtor resides in a smaller community. However, the quality of this information, like that furnished by the salesman, depends practically entirely on the ability and diligence of the individual attorney. We may add that, in general, the attorney's report is apt to be less dependable than that of the properly trained salesman's. This may be accounted for in several ways. In the first place, the attorney may be quite friendly with the merchant to be investigated, and in all probability the attorney will give his friend the benefit of any doubt that may exist, especially where merely an opinion is requested. In the second place, many attorneys have a strong prejudice against foreign creditors, that is, creditors living in other cities or states, and do not hesitate to color their reports to bolster the credit standing of local merchants. They can do this and yet not appear to have absolutely disregarded the truth, for the attorney's reports are based largely upon

opinions or hearsay. A third reason why many attorneys do not give satisfactory reports is because this work of furnishing information to distant creditors is merely an incidental matter for the attorney. And this is especially true where the attorney is of the better grade having a large practice, for such an attorney is often too deeply engrossed in important cases to give adequate attention to a request for credit information on a local merchant. Fifth, the compensation paid to the attorney, to which reference is made below, is hardly commensurate with the amount of work that would be involved in making a thorough investigation of the local merchant. In fact, the insufficiency of the remuneration is in itself a strong incentive to the attorney to give off-hand opinions without substantiating them with any investigation. Sixth, the attorney is usually not acquainted with the policy or credit standards of the house making the inquiry and consequently his opinions, based on entirely different standards, may be misinterpreted.

On the other hand, many credit men contend that the reports of most attorneys who specialize in collection work can be relied upon as being accurate and complete for, it is contended, anxiety of these attorneys to furnish creditors with trustworthy information and thus win their good-will and collection business more than offsets any friendly local ties. Furthermore, it is said that the commission earned by the attorneys from the collection business obtained from creditors is sufficient compensation to induce the attorneys to make a thorough investigation of the local merchants. That

this is true in a great many cases is undisputed. Nevertheless, we should not forget that there are many reasons, which have been enumerated, why the attorneys' reports are not always dependable. In any event, the quality of the report rests upon the qualities of the attorney reporting, and there is always some difficulty in securing the right kind of an attorney, for the better qualified the attorney, the more likelihood that he will be so busily engaged in serving local clients that he will have but little time to devote to the interests of outside creditors.

There are, however, numerous individual attorneys and firms which make a specialty of collection work and even of furnishing credit information. They have efficiently trained employees for conducting credit investigations and highly developed office systems for keeping records relating to the credit standing of customers of clients. The reports of these attorneys are usually very reliable. In fact, many credit men find that they sometimes obtain the first intimation of an impending failure from these attorneys.

COMPENSATION OF REPORTING ATTORNEYS


In return for furnishing business houses with credit reports, the attorney is either directly paid a small fee, usually one dollar, for each report furnished, or is indirectly compensated by the reciprocity of the business house in turning over its collection business in the locality to him. When the business house has some collections in the town where the attorney is situated, and actually does send them to him, the latter

system of payment has been found satisfactory to both parties. But when only an extremely few collections are sent at distant intervals, and the requests for reports are numerous, the attorney is usually dissatisfied and will slur his reports. Then there are many houses which make wholesale inquiries among attorneys, *promising* (but seldom giving) them collections for their services in rendering credit reports. Sometimes these houses send the same requests and make the same promises to two or three attorneys in one town, when obviously the collections can hardly be sent to more than one. It is not surprising, under these circumstances, to find attorneys who are not very responsive to requests for credit information, when the only compensation for their service is a mere *promise* of collections. Of course, it is true that practically all attorneys who specialize in collections will send a report to any house requesting it. This is done in the hope that some collection business may be forthcoming. But the quality of such reports is usually inferior. Where collections are actually sent, or where a fee of one dollar accompanies the inquiry, the attorney will give much closer attention to it and prepare a more reliable report. The attorney is thoroughly justified in pursuing this course, otherwise many merchants would impose on him beyond reason. It is, therefore, always advisable to enclose a fee, commensurate with the investigation involved, when requesting a credit report from an attorney, unless, of course, the attorney is actively engaged in making collections for the inquiring house, when the fee can properly be omitted.

ATTORNEYS' LISTS

The names of attorneys who are willing to serve commercial houses as collectors, and incidentally, as

Sub. No. 108,470	DETACH AND SEND REPORT BELOW TO	Expires May 25, 1916
	M. A. HANNA & CO.,	
	Coal, Coke, Iron Ore and Pig Iron, COAL DEPARTMENT,	
Leader-News Bldg.,		CLEVELAND, O.



This sheet has been submitted to THE MARTINDALE SERVICE and should be sent to you with copies of your report on which this sheet was used. It is not to be used as a basis for any report or action on the credit of said party, but merely as a reference and not the agency.

John W. ...

Name of party reported _____ Date _____ 19__

ATTORNEY WILL PLEASE DETACH, READ AND FILE THIS SHEET, AND NOT REVEAL NAME OF INQUIRER

Confidential "Form A"

To _____, _____, _____ 19__

Expires May 25, 1916

At _____

Dear Sir:—Kindly favor us with as full a report as possible of the party, or firm, named below, which we please you we will treat in the strictest confidence. If it is so in enclosed stamped envelope. We will gladly reimburse your business when ever opportunity occurs. A return note will be duly acknowledged. Subscriber's No. 108,470

Name _____ Business _____

Address _____

1. Full individual name _____ Age, married or single _____

2. How long in business _____

3. Habits and business ability _____

4. Estimated value of stock _____

5. Reports as to promptness _____

6. Any loans taken out _____ Any debts in Attorney's hands _____

7. Ever failed _____ Failed to pay _____

8. Cash market value of real estate _____

9. Net unencumbered value of real estate _____

10. In whose name recorded _____

11. Chattel mortgages _____

12. Any business outside of business _____

13. What is your line of net worth _____

14. Going ahead _____ Holding over _____ Going behind _____

15. Is party paid for _____ day's time _____ If not, why not _____

Remarks _____

Continue report on other side or make report on your own stationery, typewritten if possible, but cover all points in your answer.

Form B

credit reporters, may be found in a number of published attorneys' lists. These lists are compiled by publishing houses, which usually charge each attorney a small fee for listing his name. The publishers make

an effort to secure the names of one or more reputable attorneys specializing in commercial work in each community. To do this is not always possible, as many towns in states where the requirements for admission to practice law are very low have not even one reputable attorney. Where this is the case, an attorney in an adjacent town or in the county seat is listed. The publishing houses do not usually make a very thorough investigation of the attorneys listed. Instead, they follow the practice of weeding out those names about which complaints are made by business houses. Thus, after several years of compiling lists, the publishing house succeeds in collecting a comparatively good list of reputable attorneys.

These lists, published at regular intervals, usually annually, are then distributed to mercantile houses. In most cases no charge is made for the lists, the publishing company relying entirely on the listing fees received from the attorneys; in other cases an annual charge as high as twenty-five dollars is made for the lists and forms that accompany them.

ATTORNEYS' REPORT FORMS

In addition to supplying lists, the publishing companies usually furnish forms on which attorneys may submit reports. A typical comprehensive form is found on the preceding page. In making inquiries of attorneys a form like the one given usually produces better results than a mere general request for credit information. The form given is, of course, merely suggestive and should be modified to meet the require-

ments of the individual creditor. Usually the fewer the questions asked on the form, the better the quality of the information obtained will probably be. Whenever information is wanted about one or two specific points, it is always better to write a letter than to use a general form.

BANK INFORMATION

The average merchant uses both bank and mercantile credit. One supplements the other. In all cases where a debtor obtains credit from both banks and merchants, it is, of course, essential to the safety of one that the debtor keep his credit standing good with the other. If, for instance, the debtor's credit standing should become impaired at the bank, causing the bank to withdraw banking accommodations, upon which the debtor relies, the debtor's ability to pay his mercantile indebtedness would be seriously affected. Likewise, if the debtor's mercantile credit standing were to suffer, so that he could not obtain merchandise on credit, the safety of the bank loan would probably be jeopardized.

Banks recognize this interdependence of mercantile and bank credit. For this reason, they are eager to learn whether a borrower is maintaining a good credit reputation among mercantile houses. To acquire this knowledge, banks do not hesitate to ask mercantile creditors to give their experiences and opinions regarding a customer. As a rule, the merchants answer these inquiries fully and frankly.

Naturally, the dispenser of mercantile credit is also

desirous of ascertaining whether a customer is maintaining his credit standing at the bank. In fact, any information disclosing the bank standing of a customer would be considered valuable. But, unfortunately, banks do not often give proper attention to mercantile creditors' requests for information. Seldom do the banks reply in the same spirit as do the merchants. Usually, the information which a bank furnishes is either vague and evasive, or very general, and consequently of little value. Indeed, most banks prefer not to give the detailed information which they expect when seeking credit data from merchants. In explanation the banks hold that their position is quite different from that of the mercantile creditor in respect to parting with information regarding accounts. In support of this contention, the banks point to these facts:

1. Banks work on a very small margin of profit, much smaller than is usual in mercantile pursuits.

2. Banks deal in comparatively large units. Their loans to any one customer are usually larger than the amount of credit extended by merchants.

3. A merchant is usually debtor to his bank in a much larger amount than to any mercantile creditor.

4. Banks lend not only their own funds, but also funds entrusted to them by depositors.

For these reasons, banks are compelled to surround their credits with safeguards, not usually required by mercantile creditors, and, in so doing, banks often enjoy special confidential relations with borrowers. For instance, owing to a necessary ultra-conservative policy, the bank might find it advisable to obtain a

guarantee, endorsement or collateral as security. In such a case, many banks feel that if a mercantile creditor were informed of this condition he might misunderstand the nature of the transaction and only be impressed with the idea that the borrower's credit was not considered strong by the bank. The spread of such reports would be incalculably damaging to the borrower's mercantile credit.

Moreover, the borrower often reveals to the bank private information which he does not deem necessary or advisable to make known to mercantile creditors. Banks cannot, of course, violate these confidences. Yet, in the interests of both mercantile and bank credits, the present practice of the banks in giving information could be considerably improved, and that without violating any confidence. The tendency is in this direction. In fact, many banks to-day value the reciprocal advantages of interchanging credit information with merchants and are quite liberal in imparting information to mercantile creditors. Some banks even have highly developed credit departments which are prepared and willing to give definite information concerning a depositor or customer. This information may include the following points:

- (1) The approximate amount of the customer's money on deposit at the bank.
- (2) The amounts borrowed by the customer from the bank.
- (3) The promptness of the customer in meeting his obligations, with special reference to the bank's loans to the customer.
- (4) Whether many drafts are presented to the cus-

tomer through the bank and, if so, whether these drafts are honored by the customer.

(5) The general local reputation of the customer and the bank's opinion of him.

(6) The apparent financial strength of the customer.

Where these facts are fully and frankly given by the bank they are extremely valuable to the credit man as a means of gauging the credit applicant. In the first place, these facts enable the credit man to compare and verify the amounts of "cash" and "notes payable to banks" found in the financial statement furnished by the credit applicant. In the second place, they enable the credit man to form an opinion regarding the character and general reputation of the credit applicant.

CHAPTER XI

SOURCES OF INFORMATION (*Continued*)

THE PERSONAL INTERVIEW

That it is the function of the credit man not only to safeguard his house against bad debt losses but also to assist in the promotion of sales, has already been observed. The policy of the credit department of a selling house always is an important consideration to a purchaser, when he is planning where to trade. This is founded on good business reasons. An arbitrary narrow policy on the part of the credit department sometimes causes embarrassment even to the solvent customers, while judicious, reasonable treatment often enables customers, whose affairs have become somewhat involved, to tide over their difficulties and avoid failure.

If the credit factor is to be turned in favor of the selling house, no better opportunity is offered the credit man than when he personally meets a customer or a new applicant for credit. At such meetings the credit man must have in mind that it is as important for him to inspire the good will of the customer as it is for the latter to win his confidence.

Thus the credit man can effectively co-operate with the sales department in increasing sales. However,

the credit man is never justified in loosely and imprudently dispensing credit in an effort indiscriminately to bolster sales. But giving the impression to the credit applicant he can rely upon fair and considerate treatment by the credit department is not prejudicial to most careful credit granting.

THE CREDIT MAN'S ATTITUDE

The assumption of a friendly attitude rather than that of a hostile cross-examiner is not inconsistent with the credit man's aim to be thorough in obtaining information. He wants the applicant to talk frankly and freely and this can naturally best be induced by friendliness and candor on his part. The interview should bring to light facts pertaining to the capital strength, organization, present conditions and outlook of the credit applicant's business. The extent to which the credit man will inquire into details is necessarily governed by the circumstances in each case. The credit man should bear in mind that the information thus obtained can, if desired, be supplemented by reports obtained through the usual channels.

ADVANTAGES OF THE PERSONAL INTERVIEW

The personal interview should benefit both the applicant and the credit man. The beginner, organizing with a limited capital, has an opportunity to show the credit man that he possesses character, ability and a knowledge of the business undertaken, and that

therefore he is entitled to credit. The established concern, regarding which unfavorable reports may have been circulated, can sometimes confidentially give the credit man explanations which will satisfy him that credit may be safely granted. Then, too, in an interview of this kind, the credit man, having studied many similar situations, is often in a position to offer valuable suggestions to the applicant. Moreover, a concern in good standing will sometimes find it advantageous fully to acquaint the credit man with its condition, so that he may be in a better position to reply to inquiries made by other creditors to whom the account is not well known. On the other hand the interview permits the credit man to size up an applicant, form a personal impression of his character, his ideas, and his methods of doing business and inquire closely into any feature which requires it. As a result he is prepared either to reach a satisfactory conclusion immediately, or to interpret more skilfully the information given in the reports. In this connection it should be noted that in the event the applicant deliberately omits to refer to any materially unfavorable facts, afterwards disclosed in the reports, it will have the tendency of shaking confidence.

The properly conducted interview enables the applicant to present his own case most advantageously and to receive useful suggestions; it permits the credit man to make personal observations and to inquire carefully concerning doubtful points and, finally, a free and frank discussion leads to a more satisfactory mutual understanding.

TRAVELLING CREDIT REPRESENTATIVES

In spite of the abundance of information obtainable through the various agencies and the other sources of information, described above, the credit man sometimes finds it desirable to make a more personal investigation at the place of business of the customer. These occasions arise especially when transactions with a customer involve the taking of more than an ordinary risk. In such instances the credit man will visit the customer and look into his affairs. The scope of the inquiry is governed by the circumstances in each case. When engaged in this work the credit man must exercise all his resourcefulness and tact. In the first place, he obtains all available information through the usual channels and is thus posted as fully as possible before he makes his call. This information serves as a guide when interviewing the customer. In the interview the credit man, diplomatically, gives the customer an opportunity to explain at least all the points in the reports which cast a doubt upon his title to credit. To what further extent the investigation will go depends upon the circumstances of the individual case. In some cases it may be sufficient to secure an up-to-date financial statement and simply to discuss conditions generally. If the granting of an abnormal line of credit is to be considered, or if serious weaknesses are disclosed the investigation will be much more thorough. Under these circumstances, the credit man may feel warranted in examining the books and in making other inquiries to satisfy himself as to the financial strength, business methods, and business abil-

ity of the customer. For instance, the credit man may make observations of the orders on hand, the cost calculations, the stock, the organization, and the general management of the business of the customer.

In the course of the conversation with the customer the credit man will acquire an idea of the future outlook and also of the customer's plans and policies. In fact if the interview is conducted in the right spirit the debtor himself will frequently encourage a most exhaustive study and discussion of his affairs. The credit man, in turn, in view of his broad experience, may offer useful suggestions.

Some houses, on account of the nature of their business, find it advantageous to employ representatives to travel over specified territories, as do salesmen, and visit all customers for the purpose of inquiring into their credit standing. These investigators inquire into the financial status, take note of the management, and look into all other conditions which may affect the customer's debt-paying ability. They also make inquiries at the banks and sometimes of other parties to learn how the customer stands in the community. By visiting the banks in person, the credit man or his representative can usually obtain more definite and reliable information than can be obtained by correspondence, for the banker can hardly assume a non-committal attitude when talking face to face with the credit man.

In addition to the foregoing, the traveling credit investigator can make valuable observations regarding local conditions which affect the customer. For this, the credit investigator is usually much better equipped

than the salesman. Moreover, the credit investigator's report is more dependable than that of the salesman for the former is not apt to be colored by over-optimism.

CORPORATION MANUALS, SUPPLEMENTS AND CARDS

Houses which sell materials and supplies on credit to railroads and public utility concerns may obtain important and valuable information from corporation manuals and corporation cards. These are published by three or four concerns primarily for the use of individuals, trustees and banking houses which invest in the securities of large corporations. However, the manuals and cards usually contain comparative balance sheets and income statements of all large corporations over a period of ten or more years, and this information is practically indispensable to the well informed credit man.

The best known manuals are Moody's and Poor's. Each of these is published annually in two sections, one for railroads, and another for public utility and large industrial concerns. In each is found the most recent available income statement and balance sheet, a summary of financial statements for several years back, a short description of the important assets, and a brief history of the development of each corporation.

CORPORATION CARDS

Certain publishing houses issue the same information in card form. The best known of these is the

Standard Statistics Company, which furnishes its subscribers with two cards on each large corporation, one of which contains practically the same information as the manuals, while the other contains more recent information, such as monthly statements of earnings, current rumors or reports of the business prosperity and business difficulties of the particular corporation, etc. New cards on each corporation are issued to the subscribers as new reports come out. A cabinet is also supplied to hold all the cards.

The credit man who does not desire the complete service may obtain cards on individual companies at a nominal cost.

In addition to the above, the various publishing companies issue either daily or monthly sheets containing revisions and current information on all companies listed in the manuals or on the cards.

At least one of these services should be at the command of the credit man of a house selling to railroads and public utilities. Even the credit man of the house selling to large industrial corporations can obtain important information in convenient form from these sources.

TRADE AND FINANCIAL PAPERS

To keep posted on items of interest concerning his customers and the territory served by his customers, the credit man should also subscribe for and read the trade papers of the lines in which he and his customers are interested. Then, too, a credit man of a house selling to railroads, public utilities, and large industrial corporations will do well to read regularly one

or more of the leading financial papers, where he may find items regarding his customers.

The credit man should also read carefully one or more magazines on general business conditions in the various parts of the country so that he may intelligently analyze the fundamental conditions affecting the ability of his customers in different localities to make prompt payments. In this connection the services of the Babson and the Brookmire statistical organizations are a valuable means of keeping informed on changes in fundamental business conditions.

CHAPTER XII

THE FINANCIAL STATEMENT

One of the most important sources of credit information is the financial statement of the debtor or credit applicant. From this statement can be obtained certain facts that are not available to the credit man from any other sources. For example, the details of the credit applicant's assets, liabilities, insurance, encumbrances, and, in some cases, the debtor's income and expenses, may be obtained through the financial statement. These are essential facts; and when fully and accurately stated are especially illuminating in the ascertainment of the financial strength of a concern.

STATEMENTS OBTAINED THROUGH THE AGENCIES

By far the greatest number of financial statements come through the commercial agencies, but these are frequently incomplete or too inadequate to be used by the credit man as a basis for intelligent analysis. Moreover, the financial statements in the agency reports are at times entirely out of date. Furthermore, some of the statements in the reports, on account of the reluctance of some concerns to fill out the statement forms of the agencies, are obtained orally by the agency's reporter. In such cases the merchant giving

the statement may do so in an off-hand, careless way, with little regard to the accuracy of the figures furnished. Of course then the tendency is for the merchant to overestimate his assets and to forget some of his liabilities. On the other hand, where the merchant is called upon to fill out a carefully prepared form furnished by his creditor, greater care will be exercised in compiling the statement.

REASONS FOR OBTAINING STATEMENTS DIRECT

Another reason why it is advisable for a creditor to obtain written financial statements at regular intervals direct from the debtor is the beneficent moral influence this practice exerts on the debtor. In the first place the debtor realizes that his credit standing will be influenced materially by the kind of a statement he presents. He will, therefore, keep his business and assets in as good condition as possible, so as to be able to present a favorable statement. Thus, the speculatively inclined merchant, before entering any hazardous undertaking, will stop to think of the effect of the outcome of any proposed venture on the appearance of his balance sheet. In the second place, the incompetent trader is weeded out, for as a rule he is unable to present satisfactory financial statements. If, on the other hand, statements are not required of such a trader, creditors may not discover his failings in time, with the result that they will unwisely grant credit to him permitting him to continue in business. And this is extremely unfortunate for the honest, capable dealer, for the incompetent merchant is inclined

188 CREDITS AND COLLECTIONS

63—Statement of Incorporated Co.

SENT OUT _____ NO. _____ RETURNED _____

BUSINESS ESTABLISHED 1840.

THE BRADSTREET COMPANY,

INCORPORATED

Executive Offices, 346 and 348 Broadway, New York.

*Offices in the Principal Cities of the United States, Canada, Cuba, Mexico, Australia
and in London, England, with an Established List of Corre-
spondents Throughout the Civilized World.*

NEW YORK OFFICE—346 and 348 Broadway.

New York City, _____ 191_____

M. _____

We respectfully request that you furnish us a statement of your financial condition, on the within form, in such detail as you may elect, with a view to insure the correctness of our report. By so doing the chances of error will be lessened and confidence inspired in the minds of grantors of credit.

Those of whom you buy must get information regarding your responsibility, and employ The Bradstreet Company to make the necessary investigation. That we may be better enabled to serve them and yourself is the sole object in making this request.

We ask such attention as the subject deserves.

THE BRADSTREET COMPANY.

4-10-18-2m

Per _____

189

66—Statement Incorporated Co.

Date _____ 19____

Statement made by.....

Corporate Style.....

Business

Where located—

NAME OF CITY OR VILLAGE.....

COUNTY _____

STREET AND NUMBER.....STATE.....

Date of Charter _____

Incorporated in what State.....

Commenced when _____

Succeeding whom

OFFICERS.

Full Given and Surnames.

Residence.

President

Vice-President.....

Secretary	
------------------	--

Treasurer.....

Manager	
----------------------	--

DIRECTORS.

Full Given and Surnames.

Residence.

--	--

--	--

--	--

<p>*****</p>	<p>*****</p>
--------------	--------------

CAPITAL

	Authorized	Subscribed	Paid in
Common Stock,	\$ _____	\$ _____	\$ _____
Preferred Stock,	\$ _____	\$ _____	\$ _____

HOW PAID IN:

In cash,	\$ _____	
Patents, trade-marks, patterns, etc.,	\$ _____	
In other property,	\$ _____	\$ _____
Give particulars and the value of each kind of property _____		

ASSETS, _____ 19

Cash in bank,	\$ _____
Cash on hand,	_____
Notes receivable, actual value,	_____
Accounts receivable, actual value,	_____
Merchandise (finished and unfinished),	_____
Raw Material,	_____
Machinery and fixtures,	_____
Real Estate,	_____
Other investments (specify) _____	_____
_____	_____
_____	_____

TOTAL ASSETS, \$ _____

How much, if any, of above Accounts Receivable have
been assigned or pledged for loans, . \$ _____

LIABILITIES, _____ 19

Capital stock paid in,	\$ _____
Surplus and undivided profits,	_____
Bills payable,	_____
Accounts payable,	_____
Bonded debt,	_____
Mortgage on real estate (not included as Bonded debt),	_____
Chattel mortgage on all kinds of property	_____
Borrowed money from banks (not included above),	_____
" " " individuals (not included above)	_____
All other liabilities,	_____

TOTAL LIABILITIES, \$ _____

How much, if any, of the above indebted-
ness is past due, \$ _____

Over

THE FINANCIAL STATEMENT 191

Amount of annual business, \$ _____

Amount of annual expenses, _____

Annual dividend, _____

Surplus (not including undivided profits), \$ _____

Indebtedness of company to stockholders included in liabilities _____

Amount of insurance on merchandise, \$ _____

Amount of insurance on buildings and plant, \$ _____

Ever had a fire; if so, give particulars _____

Is plant protected by automatic sprinklers _____

Other interests of *principal* directors _____

Bank with _____

TRADE REFERENCES FROM WHOM PRINCIPAL PURCHASES ARE MADE.

<i>Give Address of Each.</i>	<i>Amount Owing</i>
Name _____	\$ _____
Address _____	_____
Name _____	\$ _____
Address _____	_____
Name _____	\$ _____
Address _____	_____
Name _____	\$ _____
Address _____	_____
Name _____	\$ _____
Address _____	_____
Name _____	\$ _____
Address _____	_____

REMARKS.

Sign here _____

Official Signature.

to undersell, especially when he needs funds, regardless of costs, and thus offer the meanest kind of competition. Creditors, for their own good and profit, should protect the competent trader against such competition. This can be done very effectively, as we have seen, by demanding financial statements. In the third place, creditors, by demanding financial statements, can frequently deter dishonest debtors from committing frauds. This is accounted for by the fact that false statement laws have been enacted in a number of states, which make it a crime for a merchant to present a false statement in writing for the purpose of securing credit.

FALSE STATEMENT LAWS

How the false statement laws act as a deterrent upon fraudulent debtors is perhaps best described in a memorandum prepared by Julius Henry Cohen, as counsel for the National Association of Credit Men. It should be remembered that it was chiefly through the instrumentality of this association in co-operation with its local constituents, the bankers' associations and other commercial organizations, that the false statement laws of the several states were enacted. The memorandum reads:

Nearly every state has some form of statute for the punishment of offenders who obtain money or property by means of false pretenses or representations; but such statutes have proved inadequate in numerous cases where frauds have been perpetrated in

connection with false statements of condition. Experience has shown that a special statute upon this particular subject is necessary. The present law ¹ is broad

¹ A uniform false statements law enacted in New Jersey, New York and Rhode Island and pending in other states. The New York Act, which may be taken as an illustration, provides:

(1) Any person who shall knowingly make or cause to be made, either directly or indirectly, or through any agency whatsoever, any false statement in writing, with intent that it shall be relied upon, respecting the financial condition, or means of ability to pay, of himself, or any other person, firm or corporation, in whom he is interested, or for whom he is acting, for the purpose of procuring any form whatsoever, either the delivery of personal property, the payment of cash, the making of a loan or credit, the extension of a credit, the discount of an account receivable, or the making, acceptance, discount, sale or indorsement of a bill of exchange, or promissory note, for the benefit of either himself or such person, firm or corporation; or

(2) Any person who, knowing that a false statement in writing has been made, respecting the financial condition or means or ability to pay, of himself, or such person, firm or corporation in which he is interested, or for whom he is acting, procures, upon the faith thereof, for the benefit either of himself, or of such person, firm or corporation, either or any of the things of benefit mentioned in subdivision one of this section; or

(3) Any person who, knowing that a statement in writing has been made, respecting the financial condition or means or ability to pay of himself or such person, firm or corporation, in which he is interested, or for whom he is acting, represents on a later day, either orally or in writing, that

enough to cover all cases of the making of false written statements to procure property or credit in any form, including cases where such statements are made directly to the one from whom property or credit is sought, as to a merchant or to a bank, or indirectly, as where made to a mercantile agency or a note broker to be used as a source of reliance by the banker who loans money and purchases paper, or by the merchant who sells goods. Furthermore, it aims at the person who makes the statement or causes it to be made, whether such person seeks the credit for himself or for any other person, firm, or corporation. Subdivision 1 punishes the mere making of a false statement in writing, with intent that it shall be relied upon, for the purpose of procuring credit; subdivision 2 punishes the person who procures property or credit upon the faith of a false statement, such person not necessarily being the one who made the statement; and subdivision 3 punishes the person who falsely represents that a previous written statement is true with respect to present financial condition and thereby procures credit.

such statement theretofore made, if then again made on said day, would be then true, when, in fact, said statement if then made would be false, and procures upon the faith thereof, for the benefit either of himself or of such person, firm or corporation, either or any of the things of benefit mentioned in subdivision one of this section,

Shall be guilty of misdemeanor and punishable by imprisonment for not more than one year or by a fine of not more than \$1,000 or both fine and imprisonment.

DIFFERENCES IN THE THREE STATUTES ENACTED IN
1912

In New York and Rhode Island the republication of a statement under Subdivision 3 may be made "either orally or in writing." In New Jersey the words "either orally or" are omitted, so that reaffirmance of the statement must be made in writing. The only other difference is in punishment. In New York the punishment is imprisonment not exceeding one year, or by fine not exceeding \$1,000, or both. In Rhode Island it is imprisonment not exceeding one year, or by fine not exceeding \$500, or both, and in New Jersey it is imprisonment not exceeding three years and a fine not exceeding \$1,000.

THE CHANGED CONDITION BROUGHT ABOUT BY THE
STATUTE

In order to restrain the making of false statements, it is now made a crime to make such a statement falsely "with intent that it shall be relied upon."

Heretofore, the only statutes under which prosecutions could be maintained in most states, and especially in the state of New York, were the statutes relating to larceny. The Penal Law (Section 1290) made it a felony for any one fraudulently to procure from another, by means of false pretences, any property. In order to come within this statute, it had been necessary to prove "the intent to deprive or to defraud a true owner of his property, or to appropriate the same to the use of the taker or of any other person" . . . "by

color or aid of fraudulent or false representation or pretence." As this law was the development of the original law of larceny from the person, i. e., the physical taking of property from another, it had been necessary to establish the following elements in order to come within the statute:

- (a) The intention to deprive or defraud the true owner of his property;
- (b) The obtaining of the property;
- (c) Fraudulent or false representations or pretences.

There was required, in addition to proof of the falsity of the pretences and the making of the pretences, proof of reliance thereon by the person who was defrauded, and of delivery of property to the defendant charged with the crime. Many examples might be given of the difficulty of establishing so complete a chain of evidence. For example, in a recent case in New York, the prosecution wholly failed because of the inability to trace the property directly to the defendant. As modern business is now conducted, it is very rarely indeed that property passes from hand to hand,—directly from the seller to the purchaser. Usually the goods are shipped by express, and all that the seller holds is a receipt signed by some clerk. To meet the rules of evidence it was necessary to call sometimes as many as twenty witnesses to trace the property from the complainant to the defendant (although, as a matter of fact, everybody was morally certain that the defendant got the goods and put them in stock). In

addition, it was necessary to show that the defendant did not intend to pay for the goods.

Besides, it frequently happened that a merchant, hoping to tide over his difficulties, would exaggerate the statement of his assets and liabilities, but with no intention to defraud the merchants who extended credit to him. In all cases of larceny, the court would charge the jury that if they found that the defendant honestly intended to pay for the merchandise, even though they found that the statement was false, they must, nevertheless, acquit.

The new statute meets all of these difficulties. The only elements of proof required against the defendant are:

- 1st: That he made a statement;
- 2nd: That the statement is false;
- 3rd: That he made it with the intention that it should be relied upon;
- 4th: That he made it for the purposes of securing credit in some form or other.

It is clear that a statement may be false without being fraudulent; that is to say, it may be exaggerated without intention to defraud any one. It may be untrue in fact, but it may be made with innocent intent. The merchant may intend to continue business and pay for the goods. The new statute, however, stops precisely this thing and makes it a misdemeanor to make a false statement, even without fraudulent intent. It is based upon the same principle that makes the carrying of a deadly weapon a crime. If the weapon is used

to commit murder, the defendant is guilty of murder, but we do not wait until he commits murder if we find him possessed of a deadly weapon. The possession of instruments of crime is made a crime, so as to deter the commission of more serious crime. Hence, the making of a false statement, even though without fraudulent intent, is made a misdemeanor.

One of the weaknesses of the larceny law as it existed was that it required proof of the physical delivery of property to the defendant. In consequence, mere extension of time in which to pay a debt already existing could not be made the basis of a charge of larceny. To the business man the extension of credit is synonymous with the delivery of something of value, but it is not "larceny" within the meaning of the statute. In like manner, there was great doubt as to whether or not the passing of a discounted note to the credit of a depositor constituted the passing of property from the bank to the depositor within the meaning of the statute. The language of the new statute is devised to meet precisely such situations.

The second paragraph of the new law covers the case where one member of a firm makes the statement and another procures the credit or property thereon, and also the case where the director of a corporation procures property for the benefit of the corporation instead of for himself.

The third section provides for the case of a "re-uttered statement," that is, where the statement has been made in writing and subsequently republished, either orally or in writing, on a later date. This provision is (except in New Jersey) that any person "who,

knowing that a statement in writing has been made . . . represents on a later day, either orally or in writing, that such statement theretofore made, if then again made on said day would then be true, when in fact said statement if then made would be false, procures upon the faith thereof any of the things mentioned in the statute, is likewise guilty of a misdemeanor."

Summing up the change that is made in the law, it may be said that the man who with deliberate intent starts out to defraud his creditors must now reckon upon different provisions of the law than were in existence before. If he steals goods from his creditors, by means of false pretences, he will, as before, render himself liable for prosecution for larceny.

As for the man who seeks to bolster up his credit, without any intent to defraud his creditors, but with the deliberate intent to build up his business, he should be upon his guard. If he should subsequently go into bankruptcy, and the falsity of the statement be discovered, upon proof of the falsity of the statement he may find himself charged with crime under the provisions of the law relating to "false statements," and it will not avail him that proof of the delivery of the property to him cannot be made. If he made the false statement, knowing it to be false, with the intention that it should be relied upon for the purpose of obtaining credit, he is guilty of a misdemeanor.

If it be said that this law is drastic and may reach honest men who are not intentional criminals, the answer is two-fold. First, there is little risk of convicting men who make honest failures. It rarely happens that men who surrender all of their property to their

Merchandise. On what basis valued, cost or market.....
Finished §..... Unfinished §..... Raw §.....
 If any goods are on consignment, state amount and circumstances.....

Sales and Profits Last Fiscal Year. Net sales §.....
Net profits §.....
Accounts and Notes Receivable. If any past due or doubtful state
 amount and circumstances.....

 If any amounts are due from members of the firm, employees,
 branches or similar sources, state amounts and circumstances.....

Bonds and Stocks. State general character and if readily salable at
 value stated.....

Insurance. Fire, on Buildings §..... Merchan-
dise §..... Life, in favor of firm §.....

We hereby certify that the foregoing figures are taken from the books of our firm and that they and the statements contained on both sides
 of this sheet are true and give a correct showing of our financial condition.
 Signed this.....day of.....191..... Firm Name.....

By.....

(07712)

Member of Firm

Contingent Liability. As indorser §.....
 As guarantor §.....No accounts have been sold or
 assigned except as follows:.....

Accounts and Notes Payable. If any are past due state amount and
 circumstances.....

 During last fiscal year current liabilities were at maximum
 (\$.....) on.....and at a minimum
 (\$.....) on.....
Mortgages and Other Liens. State due date of mortgages and on
 what assets a lien.....
Is mortgage a lien on any current assets?.....
 If any other liens on assets, state amount and circumstances.....

Reserves and Depreciation. State what provision is made.....

creditors find any difficulty in gaining their feet. Second, the mere existence of the statute is a deterrent to crime, because the business man will hereafter stop and think before putting his signature upon written statements.

As a basis for building up the credit of this country the statement of financial condition has become an instrument of great importance. The signed check may have no greater value than five dollars, but the signed financial statement may have a value of many thousands of dollars. Let the man who makes a statement in writing realize that he assumes responsibility as great as that of signing a check; and that before signing it he must know that he has the assets and the surplus mentioned therein. The entire theory of the law is that if those who extend credit do so in reliance upon information within the knowledge and control of the person giving it, the person giving it should not give false information, except at his peril.

It must not be forgotten that the honest business man benefits by every extension of the criminal law that reaches the dishonest business man. No man can compete with another who buys goods that he never intends to pay for. The latter can afford to sell his goods below cost. The honest merchant has nothing to fear from the new statutes, but the dishonest merchant has everything to fear.

THE FEDERAL LAW

In addition to the various state laws making the issuance of false statements for the purpose of obtain-

ing credit a crime, there is a Federal law ¹ under which debtors who have secured merchandise on credit by mailing false financial statements may be successfully prosecuted. To obtain a conviction under the Federal law, which imposes more severe punishment on fraudulent debtors than do the state laws, it is necessary to prove not only that the debtor issued a false statement in writing and secured merchandise on credit on the basis of the statement, but also that the statement was sent through the mails. Therefore, in order to aid in the prosecution of fraudulent debtors under the Federal law, the creditor receiving a statement through the mail should attach the envelope in which the state-

¹ U. S. Crim. Code, Sec. 215:

"Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretences, representations or promises—shall, for the purpose of executing such scheme or artifice or intention so to do, place or cause to be placed, any letter, postal card, package, writing, circular pamphlet or advertisement, whether addressed to any person within or outside the United States, in any postoffice, or station thereof, or street or other letter box of the United States, or authorized depository for mail matter, to be sent or delivered by the postoffice establishments of the United States, or shall take or receive any such therefrom, whether mailed within or without the United States, or shall knowingly cause to be delivered, by mail according to the direction thereon, or at the place at which it is directed to be delivered by the person to whom it is addressed, any such letter, postal card, package, writing, circular pamphlet or advertisements, shall be fined not more than the \$1,000, or imprisoned not more than five years, or both."

ment is received to the statement itself and retain both in his files. To facilitate retaining the envelopes, the National Association of Credit Men has devised a combined statement form and mailing envelope, a copy of which is reproduced on page 206.

REASONS WHY MERCHANTS SHOULD FURNISH STATEMENTS

Thus far we have indicated some of the reasons why it is advisable for selling houses to obtain statements from credit applicants and several reasons why it is desirable to obtain these statements direct. But even to-day many debtors do not take kindly to the creditor's request for a copy of the latest financial statement. These debtors regard such a request as too inquisitorial in nature. Fortunately, however, the number of such debtors is comparatively small and ever decreasing. Most debtors, being conscious of the exactions upon the credit system made necessary by present day business conditions, freely issue statements to the banks and merchandise creditors. Most debtors realize that by giving a statement they are helping to improve their own credit standing (if they are worthy of credit) and are assisting in strengthening the entire credit system. The honest, successful debtor knows, as we have pointed out above, that the statement is an effective instrument for eliminating the competition of fraudulent and incompetent debtors. Moreover, the preparation of statements by a debtor enables and compels him to have some kind of an accounting system

and to look into his financial condition, both of which unquestionably result in some benefits to the debtor.

RECIPROCAL VALUE OF STATEMENT

On the one hand, the debtor desires to obtain credit as a means of increasing his business. The prudent man, however, will seek only so much credit as the normal healthful expansion of his business will permit. On the other hand, the aim of the credit man is to give a fair measure of credit. The interests, then, of the good trader and the credit man are not in conflict. On the contrary, the right-thinking debtor realizes that the credit man is entitled to confidential information regarding his business and that his interests are best served by securing the confidence and co-operation of the enlightened credit man. Both realize that a business is more jeopardized when it receives too much than when it receives too little credit. The statement, presenting most concretely the financial condition of the debtor, is indispensable as an aid to the determination of how much credit can be safely absorbed. The credit man, who wants to base his conclusions as much as possible on facts, should have this information, and the debtor who wants the credit man's confidence and co-operation should willingly give the facts.

Considering the benefit the debtor obtains through credit, he can usually offer no valid objection to giving information which serves as a basis for the credit man's proper consideration. The intelligent merchant realizes that a request for a statement is not a challenge of his good faith, but simply a desire on the part of the credit

PROPEKTY STATEMENT BLANK

Adopted and Recommended by the National Association of Credit Men
RICHMAN & CO., NEW YORK, N. Y.

For the purpose of obtaining credit and to induce you to sell me (us) merchandise, I (we) make the following statement in writing, intending that you should rely thereon respecting my (our) financial condition.

[illegible]

man to judge for himself how well the capital in the business is protected and how much credit can be safely given. The debtor and creditor are mutually interested. To impress these facts on the minds of all merchants, the National Association of Credit Men, which has been a powerful force in quickening beneficent education in credit, has prepared a statement and has had it printed on the first page of the financial statement blank recommended and endorsed by the Association. The statement reads:

"Good credit in the markets of the world enables every merchant to add to his ability to do business. It gives him the use of enlarged capital, thus enabling him to carry a more complete stock, increase his sales, and magnify his profits.

"Large assets are not always necessary to the creation of credit; what is most desirable is, that credit be in relative proportion to the actual assets, and in harmony with conditions which create and maintain it. A merchant's capital is the sum of his net available resources, plus his credit. The giver of credit is a contributor of capital, and becomes, in a certain sense, a partner of the debtor, and, as such, has a perfect right to complete information of the debtor's condition at all times.

"Credit is given a merchant because of the confidence reposed in him. Requesting a statement when credit is asked is not a reflection on one's character, honesty, or business ability, but is done to secure information to enable business to be conducted intelligently.

"When a statement is made it should be absolutely correct. To make it so necessitates the taking of at

PROPERTY STATEMENT BLANK

Recommended and endorsed by the National Association of Credit Men.

"Large assets are not always necessary to the creation of credit; what is most desirable is, that credit be in relative proportion to the actual assets. The giver of credit is a contributor of capital, and becomes, in a certain sense, a partner of the debtor, and, as such, has a perfect right to complete information of the debtor's condition at all times."

DATE.....191

To RICH, MANN & CO., New York

For the purpose of obtaining credit for goods to be sold me or us by you, or for any extension granted me or us on my or our account with you, the following is given you as a true statement of my or our assets and liabilities and general financial condition. I or we agree to and will notify you immediately in writing of any materially unfavorable change in my or our financial condition, and in the absence of such notice, or of a new and full written statement, this may be considered as a continuing statement and substantially correct.

BUSINESS ASSETS		Dollars	Cents	BUSINESS LIABILITIES		Dollars	Cents
Value of merchandise on hand at cost.....				Owe for Merchandise, not due.....			
Store Furniture and Fixtures.....				Owe for Merchandise, past due.....			
Cash in hand.....				Owe Notes for Merchandise.....			
Cash in bank.....				Owe Banks.....			
Accounts good and collectible.....				Owe Relatives and Friends.....			
Notes good and collectible.....				Owe Taxes.....			
Store, Building and Lots.....\$ } Equity				Owe Rent.....			
Mortgaged.....				Total Business Liabilities.....			
Other personal property.....				Net Worth in Business.....			
Total Business Assets.....				TOTAL.....			

If any of above liabilities are secured, state particulars in proper place below

FULL GIVEN AND SURNAME OF EACH PARTNER		Age	Married	Business as partner sum on balance

Dollars	Cents

OUTSIDE ASSETS

Total Real Estate owned.....
Less exempt portions.....

Total Real Estate not exempt.....	Nature of Business.....
Encumbrances on Real Estate not exempt.....	Insurance on Merchandise.....
Net Equity in Real Estate not exempt.....	Insurance on Real Estate.....
Other Property not exempt.....	Insurance on Furniture and Fixtures.....
Total Outside Property.....	Insurance on Other Property.....
Debts not enumerated above.....	Pay Rent on Store, per month.....
Net Outside Assets.....	Commenced Business.....
Net Worth in Business.....	Lease Expires.....
Total Net Worth in and out of Business.....	Bank with.....
	Date of last Inventory.....
	Ever burned out.....
	Keep following Books of Account.....
	Annual Expenses.....

Included in Liabilities in Above Statement:

Mortgage on Merchandise.....	Suits pending.....	Merchandise, Consists of
Mortgage on Furniture and Fixtures.....	Judgments.....	Dry Goods.....
Mortgage on Horses and Wagons.....	Judgment Notes.....	Notions.....
Mortgage on Other Personal Property.....	Mechanics' Liens.....	Clothing.....
What proportion of Sales is on Credit.....	Amount of Sales last year, \$.....	Books and Shoes.....
REMARKS— Give details and explanations of questions not fully answered above.....		Hats and Caps.....
		Groceries.....
		Crockery.....
		Hardware.....
		Total.....

The above statement, both printed and written, has been carefully read by the undersigned, and is a full and correct statement of my or our financial condition as of.....191.....

Town..... State.....
 By..... a member of the firm
 On the reverse side of this sheet is given a complete list of losses 1 or we deal with, and amount on each one; also a description of all Real Estate owned.
 Standard Form D.

least an annual inventory and the keeping of an accurate set of books. Statement giving, therefore, will tend to make a debtor a better buyer, because more familiar with his stock, more careful in giving credit, more conservative in incurring debt, and will result in a better knowledge of his business generally.

"A merchant who desires to serve his own best interests should recognize that his most valuable possession, apart from his actual assets, is a sound, substantial and unquestioned reputation as a credit risk, and that, under the prevailing conditions and demands of business, the most effective, and eminently the best way to prove his basis for credit, is to be willing to submit a statement of his financial conditions.

"NOTE: The above estimate of the value of a statement to both giver and receiver is the embodiment of the thoughts and experiences of scores of the leading credit men of the United States, who are members of the National Association of Credit Men, and who thus desire publicity given to their views in order that there may be the largest benefits to both retailer and wholesaler."

PRACTICE IN OBTAINING STATEMENTS

As was stated above, there are two methods of obtaining financial statements—the direct and the indirect. In spite of the advantages accruing to both creditor and debtor through the use of the direct method of obtaining statements at regular intervals, there are comparatively few houses that follow the practice. Most creditors are content to use the indirect method, i. e., to rely on the information and statements obtained through the general agencies and other sources heretofore described. If the information obtained in this

way is incomplete or unsatisfactory, a request is made for a statement direct.

Some creditors make a practice of calling for a statement when in doubt of the standing of the debtor. When this practice is followed, the credit man either receives information which enables him intelligently to arrive at a decision, or if the request for a statement is not complied with, the credit man is in a position tactfully to turn down the account. The debtor, whose condition is seriously weak, will usually prefer not to expose his condition. Likewise, the debtor who contemplates perpetrating a fraudulent failure will hesitate to issue a statement, for fear of prosecution under the false statement laws.

On the other hand, many houses, especially commission houses and banks, generally require statements from new credit applicants; and some creditors even require statements from most of their debtors at regular intervals, for example, every year. This practice, as we have already pointed out, is the ideal one. Then, too, many credit men believe, in addition to the benefits we have described, that this practice has a beneficial moral effect on the debtor, for he is impressed with the carefulness and vigilance of those creditors requesting the statement, and as a result he will try to measure up to higher credit standards.

CHAPTER XIII

CONSTRUCTION AND ANALYSIS OF STATEMENT

It is not always an easy matter correctly to understand the significance of the figures given in the statement. This is due largely to the fact that a wide latitude obtains in the preparation of statements. The difficulty of judging what the figures mean is increased because of the lack of uniformity in the statement forms used. This idea will be more readily grasped when it is understood that the figures really represent only estimates. The actual value of the assets is not ascertainable until the assets are converted into cash.

Thus while correct accountancy and sound business principles provide good rules for valuing the assets, the appraisal will be colored by the optimism or conservatism of the maker of the statement. Moreover, even though honestly made, the appraisals are susceptible to errors of judgment. To narrow these influences as much as possible, the terms in the statement form should be well defined and clearly understood.

The amount given in the statement as the worth of any one asset may be constituted of several elements. In order that the reader of the statement can form his own opinion as to its value, it is essential that he understand the composition of each item. What is the composition of each item is described in the description and

valuation of assets and liabilities found on the following pages. The analysis of assets will also in a general way illustrate how the valuation of assets should properly be made. Moreover, the analysis will point out the elements and conditions which must be considered in order to minimize the effects of the factors which tend to create a wrong impression or to mislead the credit man.

The discussion will incidentally call the reader's attention to the great need for standard statement forms. The statement form given on the following pages is an adaption of the standard forms recommended by the National Association of Credit Men. It may, of course, be changed to suit the requirements of any particular line of business.

SUGGESTED FORM OF FINANCIAL STATEMENT FOR
CORPORATIONS

Statement of.....
(Name of credit applicant.)
Business..... Address.....
To (Name of Creditor).....

For the purpose of obtaining credit now and hereafter for goods purchased, we herewith submit to you the following statement of our resources and liabilities, and we will immediately notify you of any material change in our financial condition, and in the absence of such notice or of a new and full written statement this may be considered as a continuing statement and substantially correct; and it is hereby expressly agreed that upon application for further credit, this statement shall have the same force and effect as if

delivered as an original statement of our financial condition at the time such further credit is requested.

In consideration of your granting credit to the undersigned, we agree that in case of our failure or insolvency, or in case we shall make any assignment for the benefit of creditors, bill of sale, mortgage or other transfer of our property, or shall have stock attached, receiver appointed, or should any judgment be entered against us, then all and every one of the claims which you may have against us shall at your option become immediately due or payable, even though the term of credit has not expired. All goods hereafter purchased from you shall be taken to be purchased subject to the foregoing conditions as part of the terms of sale.

Assets

Cash on Hand.....	
Cash in Banks.....	
Accounts Receivable of Customers.....	
Notes Receivable of Customers.....	
Accounts and Notes Receivable of	
Officers, Salesmen & Others.....	
Merchandise Finished.....	
Merchandise in Process.....	
Raw Material and Supplies.....	
Other Quick Assets (Itemize).....	
<i>Total Quick Assets</i>	
Land and Buildings Owned by	
Corporation Used for This Business.....	
Machinery	
Furniture & Fixtures.....	
Other Assets (Itemize).....	
.....	
Total Assets.....	

Liabilities

Accounts Payable.....
Notes Payable given for merchandise.....
Notes Payable given to banks.....
Notes Payable to others.....
Deposits of money with us.....
Other Current Liabilities (Itemize).....

Total Current Liabilities.....

Bonded Debt.....
Mortgage Debt.....
Chattel Mortgages.....
Other Liabilities (Itemize).....

Total Liabilities.....

Reserves

Total

Capital Stock.....

Surplus

Total

Officers

Name in full	Address
President
Vice-President
Secretary
Treasurer

Directors

Name in full	Address
.....
.....
.....
.....

Buy Principally from Following Houses

Name	Address	What line of Business
.....
.....
.....
.....

"Questionnaire"

- (a) **Accounts and Notes Receivable.** If any are past due, doubtful or uncollectable, state amount and circumstances.....
- (b) If any amounts are due from directors, officers, salesmen, employees, branches, state amount and circumstances.....
- (c) **Investments.**..... Itemize.....
- (d) **Insurance.** Fire, on Buildings \$.....
Plant and Machinery \$..... Merchandise \$..... Life, in favor of the company \$.....
- (e) **Accounts and Notes Payable.** State amount past due \$.....
- (f) **Mortgages and Bonds.** Due date and on what assets a lien.....
- (g) **Contingent Liability.** As guarantor or surety \$..... as indorser \$..... Other contingent liabilities \$.....
- (h) **Net Sales \$.....** (i) **Expenses \$.....**
(j) **Net Profits \$.....**
- (k) **Dividends Paid \$.....**
- (l) When was last dividend declared.....
(m) Rate.....
- (n) **In what State incorporated?**.....

ANALYSIS OF STATEMENT

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- Authorized Stock \$..... Subscribed
\$..... Paid in Cash \$..... paid
in other property \$.....
- (o) Are any merchandise creditors secured?.....
- (p) Suits pending and of what nature?.....
- (q) Is the statement based on actual inventory?.....
Date of inventory.....
- (r) Keep the following books of account.....
- (s) Bank account kept with.....
- (t) **HAVE YOU PLEDGED OR ASSIGNED ANY
OF THE ABOVE ACCOUNTS RECEIV-
ABLE OF CUSTOMERS?.....
OUR ASSIGNED ACCOUNTS RECEIV-
ABLE AMOUNT TO \$.....**

The above statement, both printed and written, has
been carefully read by the undersigned, and is a full
and correct statement of our financial condition as
of 19.....

Signed this day of , 19 .
Name
By
 (state official title)
End of Form.

DESCRIPTION AND VALUATION OF ASSETS AND LIABILITIES

Cash. This item should represent the sum of cash
on hand and in bank immediately available. It should
not include, as it sometimes does erroneously, I. O.
U.'s, which may or may not be collectable, balances in
the hands of salesmen to be used for expenses, or funds
against which liens have been filed, or which in any

way are tied up and not at the immediate disposal of the business for debt-paying purposes.

It is advisable to have the cash on hand and cash in bank stated separately. If the cash on hand seems out of proportion, the inference may reasonably be drawn that the item includes I. O. U.'s, unexpended salesmen's balances, etc. If properly stated, the cash on hand includes only the cash actually in the drawer; and the cash in the bank only so much as is not subject to any encumbrances, and should, of course, be 100% good and available for debt-paying purposes. In this connection it should be remembered that, if the merchant is indebted to the bank in which he deposits, the bank has a lien against the deposit to the extent of the loan.

Accounts Receivable. This should represent unpaid charges against solvent debtors, ordinarily for goods sold and delivered. Properly to express the net worth of this account a reserve should be created to provide for deductions, allowances, discounts, collection charges, returns, and bad debts.

The following should be excluded:—

- (1) Items reasonably known to be uncollectable.
- (2) Balances covering goods shipped on consignment.
- (3) Advances to salesmen.
- (4) Loans to officers.
- (5) Overdrafts of partners. These are really withdrawals of capital, reducing the investment.
- (6) Advances to subsidiary companies, which represent more or less permanent investments and will not

be collected from the subsidiaries in the ordinary course of business.

After cash, the accounts receivable item is the most live asset in the business of a manufacturer or jobber. It is to the total of cash plus accounts receivable that the credit man looks when trying to determine the ability of debtors promptly to meet their obligations. Therefore, the amount stated as accounts receivable should include only unpaid charges which information and past experience indicate will be paid when due or within a reasonable time. That is to say, the accounts receivable should include only those accounts which can be relied upon for payment of creditors' claims. They should not include any bookkeeping balances which are not to be collected in the usual course of business and which will not yield funds for the payment of debts. For this reason the ideal statement segregates the good "accounts receivable" for merchandise sold from all other accounts.

In trying to determine the quality of the accounts receivable found in a credit applicant's statement, the credit man may apply the following tests:

(a) Are the accounts in fair proportion to the sales? To answer this fairly, one must consider whether the commodity is sold quite uniformly over the year, or seasonally. In the latter event, regard must be had for the date of the financial statement. If the accounts seem to be disproportionately large, the probabilities are that old doubtful accounts are included and that credit has been granted indiscriminately. This is especially true in the case of a retailer. Or possibly no provision for trade discounts has been made, or ac-

counts receivable from officers or salesmen may be included.

(b) Is a large proportion of the accounts jeopardized by regional or local conditions, for example, such conditions as the sudden decline of cotton values in the fall of 1914, which severely depressed industry in the South, or economic disturbances such as strikes, which would injuriously affect the collectibility of accounts receivable in those sections?

Assuming that only balances due from solvent customers are included, the credit custom of the trade, as well as the credit policy of the house, must be considered in determining the value of the accounts receivable. In some lines of business the accounts can be looked upon as automatically convertible, that is, cash is received for most of the accounts without entailing much effort and expense. Among dry goods wholesalers and manufacturers, the percentage of bad debt losses varies from less than a fraction of one per cent to five per cent. Where a careful credit policy is pursued, the result should be close to the first figure. In industries where the profits are large the inclination is to take greater risks and a much larger percentage of losses must be expected.

Notes Receivable. This account should include negotiable promissory notes received from customers in payment for goods sold and delivered. It should not include notes from partners, officers, stockholders, employees, controlled or allied companies, or any other similar notes. For the same reasons that were urged in the discussion of the accounts receivable, these items should be differentiated from customers' indebtedness

and separately stated. Nor should instruments which have been discounted, assigned or transferred be included.

The availability of this asset for debt-paying purposes depends upon the nature of the business. In some lines of business it is the custom for concerns of even the highest standing to give notes to cover purchases. In such instances, in estimating the value of the notes the credit man should deduct an amount for bad debts based upon the average percentage of losses usual to the trade and upon the credit methods of the debtor.

In most lines of business, however, debts are usually evidenced only by open book accounts. Where this system prevails the closing of an account by note indicates, as a rule, past due indebtedness, and if the amount is a substantial one it is indicative of laxness in the extending of credit and of making collections.

With the development of the Federal Reserve System, however, it is to be expected that "trade acceptances" will replace to a certain extent both notes and accounts receivable. The "trade acceptances" should be valued in the same way accounts receivable have been valued. In fact even a higher valuation might be placed on the "trade acceptances," for they should prove easier to collect, all other things being equal, than the open accounts receivable.

Officers, Salesmen and Others. Only such part of the amount as the credit man is assured can be collected upon demand may be considered. If the item is relatively a substantial one it will bear investigation, inasmuch as it is often an index to adverse conditions.

Generally, however, this amount should be given very little weight as an asset available for the payment of debts.

Merchandise. This account refers to goods, wares, materials, products and supplies of the retailer, wholesaler or manufacturer—that is, finished goods, goods in process and raw materials and supplies owned by the one who submits the statement and which are to be sold in the ordinary course of trade. This amount should not include any part of the stock which has been pledged as security or which is subject to any liens.

In appraising the worth of this asset it is necessary to consider what methods the maker of the statement employed in taking inventory.

First, how is the quantity of the stock of merchandise ascertained? Is it the result of a physical stock-raising, as it should be, or does it represent book (estimated) inventory, or is it simply a guess? If the figures in the financial statement are given in round numbers, the conclusion may reasonably be drawn that the inventory has probably been a mere guess.

Second, how is the merchandise valued? Various methods are employed in valuing the merchandise. Some houses inventory their merchandise at selling price. Unless the goods have actually been sold so that the title has passed and the amount is a proper charge against the customer, this mode is manifestly wrong. It overlooks the expenses chargeable against a sale and also appropriates problematical profits which, even if later made, properly belong to the subsequent period when the sale is effected.

The question then arises: Should the inventory be taken at cost or at the prevailing market price? The more conservative practice is to use the lower figure of the two. This is based on the theory that even if the cost of the goods is less than the current market price, no profit is actually made until the goods are sold, while if the market price is lower there is usually a corresponding decline in realizable value, and conservative stock-taking would place the inventory figure low enough so that the selling price may yield the normal gross profit. In this connection it is well to consider whether cost records have been used in arriving at the inventory valuation, for only with the proper cost records can the correctness of the calculation be insured. Many merchants have suffered disastrous surprises owing to the misguidance of poor cost records.

Third, in what condition is the stock? How much is raw material? How much is finished goods? How much is goods in process?

The more nearly the merchandise is in the shape of raw material, the more likely the goods will prove to be of full value in case of forced sale. This is accounted for by the fact that changes in style seldom affect raw materials so as to make them worthless. Moreover, raw material, in the event of insolvency of the debtor, may readily be converted into cash. On the other hand, merchandise in process is worth comparatively little, for even when the parts can be utilized, much labor and time must be spent on it to put it in saleable condition. However, the finished goods may more readily be sold.

In analyzing the statement of a going concern, to ascertain what assets are available for current debt paying, the credit man should count upon only so much of the merchandise as will probably be sold within a reasonable time in the ordinary course of trade. Of course it must be remembered that, while in ordinary course of business merchandise is sold at a profit, the stock is subject to depreciation. Moreover, time, effort and expense are required to convert it into cash. Then, too, the stock is usually first converted into accounts receivable. To check up the accuracy of the inventories given in the statement and to determine whether they are too large, the credit man might apply the following tests:

First, does the stock, in view of the nature and location of the business and the time of inventory, seem out of proportion in relation to the annual sales? If so, usually either the inventories are overstated or a good part of the merchandise is an accumulation of unsaleable goods. Second, has sufficient deduction been made or a reserve provided for physical deterioration, changes of style and fashions, mistakes in buying, or decline in value for any reason?

Deferred Assets. This includes such items as unexpired insurance premiums, taxes and interest paid in advance, and other charges properly applicable to a subsequent period. While these items are not to be converted into cash in the usual course of business, and are, therefore, not available for the payment of debts, nevertheless, their presence in the statement is of some value, as it indicates to the credit man whether the

maker of the statement has a comprehensive system of keeping accounts.

Plant, Machinery and Tools. This account should represent only the above-mentioned properties owned by the business in determining their value. Furthermore, it should be seen whether or not they are subject to any mortgages or liens; it must be noted whether or not there has been a sufficient amount written off or reserve provided to cover depreciation, as a result of wear and tear, and obsolescence, due to the superior efficiency of newly invented machinery and appliances. There should, of course, be a sufficient reserve to replace machinery and maintain the efficiency of the plant.

These assets and the ones following, all of which are often referred to as fixed assets, are not to be sold in the usual course of business, and therefore contribute very little, directly, to the ability of the business to meet currently maturing obligations. On the other hand, their presence does add to the stability of the business, and in the event of a final liquidation of the business, they could be counted on to realize something, although probably not more than from ten to fifty per cent of their book value, for the payment of creditors. For this reason only the current assets, i. e., cash, accounts receivable, and a part of the merchandise, are to be considered for the probability of prompt payment of debts, and fixed assets are to be considered only as a possible source of ultimate payment.

Furniture and Fixtures. In determining the value of this item, it should be seen whether a sufficient reserve for depreciation has been provided, and, further,

whether the size of investment is consistent with the requirements, considering the nature of the business.

Real Estate. This account should represent the value of land and buildings owned and used in the operation of the business. The amount invested in each parcel should be separately shown at the cost price. This amount should be compared with the assessed valuation. It should then be noted whether adequate depreciation is provided and whether there have been any fluctuations in the market value due to changes in the neighborhood or to the nature of the construction of the building.

Intangible Assets. Under this heading may be grouped such items as copyrights, patents, contracts, good will, and franchises. They can only be realized on in a sale of the business and then usually only when as a part of the investment they are yielding satisfactory returns. To a going concern they are not resources available for debt paying, and to an insolvent concern they are usually worthless.

LIABILITIES

Accounts payable should represent the total amount owing to creditors on open account, whether due or not, for merchandise, wares and supplies purchased. The amount is not very apt to be understated, for it is easily verified by the creditors, especially in case of the bankruptcy of the debtor. A division of the item should be made, showing the amounts (1) not due and (2) past due.

Notes payable may be segregated into three groups:

(1) The amount owing on notes to merchandise creditors for supplies purchased. (2) Notes payable to banks. This represents money borrowed from the banks by discounting the debtor's own notes. Good banking accommodations usually denote strength. (3) Notes payable to others. This represents notes given when a loan is obtained or other obligation incurred from sources other than the first two mentioned. Usually these are debts payable to officers of a corporation or to the relatives or friends of an individual merchant. Their presence in the financial statement is usually a signal for the exercise of caution on the part of the credit man. In the first place, the fact that a merchant has to borrow from friends and relatives probably indicates his credit at the bank is not good or is used up. In the second place, in case the merchant becomes embarrassed he will look out for his friends and relatives first, and in this respect "debts due others" is usually an item which warns a credit man to be cautious.

Deposits should include funds deposited with the debtor as a saving feature, and also trust funds, but should not include loans obtained.

Accrued liabilities represent the amounts of wages, rent, taxes and similar items accrued on date of the statement, but not payable until a later date.

Bonded indebtedness is a liability represented by bonds, usually payable at some distant future time, and usually secured by a mortgage on the real or personal property or both.

Mortgages represent indebtedness secured by a pledge of real estate. The mortgage liability may have

been assumed as part payment for the property when title was acquired, or the mortgage may have been executed subsequently as security for a loan obtained. Property covered by a mortgage of any considerable size is usually worthless as far as creditors are concerned.

Reserves usually represent the estimated depreciation of one or more of the assets on the asset side of the balance sheet. To determine the estimated value of the asset, the amount of the reserve should be deducted from the amount of the asset.

Reserves may also be a part of the capital or surplus set aside for some particular purpose. In such a case the name of the reserve in the financial statement would usually indicate its purpose.

Capital, in the statement of an individual or firm, represents the book net worth of the business, or the investment of the owner in the business.

Capital stock, in the statement of a corporation or joint stock company, is usually the face value of stock outstanding. Sometimes, however, it is the face amount of all the stock authorized, even though some of the stock has not yet been issued. Or it might represent the total which had been issued even if some was returned to the corporation. In such a case there would probably appear on the asset side of the balance sheet an item called "Treasury Stock." The treasury stock, from the credit man's viewpoint, can hardly be considered an asset, for in the ordinary course of business it would not be converted into cash available for payment of debts. Moreover, in case of insolvency, the treasury stock is worth nothing.

The outstanding capital stock represents merely the original investment of the stockholders (the owners) in the business. It is not a liability any more than the amount originally invested by an individual in his own business is a liability of the business.

Surplus is merely a nominal account which represents the excess of the total assets over the total of liabilities plus reserves plus capital stock. The surplus plus the capital stock of a corporation represents its net worth as shown by the books. The existence of a surplus usually indicates that the corporation has at some time made profits from the operations of its business. However, it must be remembered that when a surplus exists, dividends may be declared and paid on the capital stock. A cash payment of the dividends, unless the concern is in good liquid condition, may waste or impair its working capital. Where, however, the surplus is divided into two items, such as "surplus" and "capital surplus," the intention is that dividends may be paid only to the amount of the "surplus." The "capital surplus" is appropriated to the business and is not available for dividend distribution.

CREDIT CAPACITY OF THE BUSINESS

If the assets are properly valued the surplus of the total real assets over the total liabilities equals the capital or net worth of the business. This capital, however, does not represent the credit capacity of the business. Credit strength is the power to discharge obligations. This power depends not upon the amount of the capital but rather upon the form in which it is

distributed among the assets. A concern, to maintain a good credit standing, must be prepared to meet its obligations promptly or reasonably so, while continuing as a going concern. To do this it must have a sufficient amount of its assets in liquid form or available to take care of maturing liabilities as they become due. It is, therefore, not the amount of its capital but the availability of its assets which indicates the credit capacity of the business. That is to say, it is the liquidity of condition of a business which offers a measure of the ability of the business to absorb credit. The liquidity of the condition of a business is determined by the ratio of current assets to current liabilities. Current assets consist of such items as will in the usual course of business be converted into cash within a reasonably short time and without injuring the future operations of the business. Current liabilities consist of short term obligations. The long term liabilities create current or quick liabilities to the extent of the interest which must be paid on the long term obligations.

In analyzing a statement from the credit man's standpoint, it is necessary to set off the current assets, on the one hand, against the current liabilities on the other. There must be reasonable certainty that the amount of assets convertible into cash in the ordinary course of business will be sufficient to enable the business to meet its obligations. To determine this, one must consider the nature and volume of the business, and also the terms of purchase and sale. Furthermore, in calculating the amount of current assets available for debt-paying, deduction must first be made to pro-

vide for the funds required for current expenses, such as, pay-roll, rent, and other similar running cash expenses, not listed among the obligations in the balance sheet. If, after allowance has been made for these current expenses, the amount of current assets remaining appears adequate to pay off all current liabilities, the business is in liquid condition. It is well, however, to inquire into the relative proportion of each class of the assets, and also into the nature of the liabilities. We know that the liabilities represent 100% of unshrinkable obligations. How dependable are the current assets? The items cash, receivables, and merchandise, should be compared with similar items in the statements of the most successful concerns engaged in the same line of business, having in mind whether the operations are conducted under the same policies. If an item seems to be out of normal proportion it should be further investigated. If the amount of merchandise, in comparison with other assets and in comparison with the amount found in the statements of successful similar concerns, seems excessive, it usually indicates an accumulation of inferior, stale or unsaleable stock or an overvaluation of the stock. If, in the same way, the accounts receivable seem too large, there is probably included an accumulation of old and uncollectible accounts. In either of these events, the figures are not correctly stated and should be discounted by the credit man. Moreover, the fact that they are excessively large reflects poor buying and poor credit judgment.

In connection with the liabilities it is well to note how the merchandise indebtedness compares with the

amount of merchandise and receivables. Furthermore, it is well to observe whether banks or note brokers or both are used for borrowing purposes. In any case it should be ascertained whether merchandise accounts are discounted or whether the business depends upon borrowed funds for permanent working capital. In this latter event the business would probably be in an extended condition.

WORKING CAPITAL

If the current assets exceed the current liabilities the excess is the working capital. The working capital is the index to the condition of liquidity and credit capacity of the business. The fixed assets serve as a secondary source to fortify the power to pay. However, they are not ordinarily available for paying debts in the usual course of business. Thus we find that while fixed assets are potentially realizable, they are in fact unrealizable as long as the business is a going enterprise. For this reason the credit man should give fixed assets serious consideration only in reckoning whether, if for unforeseen reasons the liquidation of the business became necessary, the ultimate collection of the debt would be possible.

FLOATING DEBT

If the total current liabilities exceed the current assets the difference is floating debt. This indicates insufficiency of working capital and denotes a top-heavy condition. This is usually a menace to the busi-

ness and often an omen of failure. Lack of working capital impairs the efficiency of a business, and while a man of good qualities would make more determined efforts, the load may be too much for any one to sustain.

In analyzing a statement showing a floating debt or even insufficient working capital it is well to consider whether too much capital has not been tied up in fixed assets, such as real estate, machinery, etc. Thus, a top-heavy condition becomes further aggravated by the necessity for having an increased amount of working capital to maintain or operate the fixed assets. Then, too, a top-heavy condition may be due to the diversion of too much capital from the business into outside investments.

COLLATERAL INFORMATION

The data called for in the questionnaire supplementing the Financial Statement, usually provides valuable information for checking the condition purported to be shown in the statement. The questions will be discussed in the order followed in the form and designated with the corresponding letter.

(a) *Accounts and Notes Receivable* past due. A large proportion of past due and doubtful accounts indicates unsatisfactory credit and collection methods and depreciates the value of the accounts due as well as not due.

(b) If any loans have been made to officers, etc., the credit man should satisfy himself on the following points: Does the condition of the business warrant

making loans to directors or officers? What is the effect of the salesman's overdrafts, seldom collectible, upon the real selling cost? If money has been advanced to a subsidiary, what is the condition of the subsidiary? How about its earning power? Has the investment been used to purchase fluid or slow assets? Is the condition such that the parent company can reasonably expect repayments reducing the investment or is the outlook such that more funds will be required, necessitating a further drain upon the working capital of the parent company? In this connection it is important to know whether the subsidiary has any liabilities outside of those to the parent company. Moreover, it is important to be well informed on these three questions:

1. What is the actual net worth of the investment, as indicated by an analysis of the balance sheet of the subsidiary company?
2. Has the subsidiary company proven to be a profitable investment?
3. What is its influence upon the working capital or financing of the parent company?

(c) *Investments.* The investments may be either stocks or securities of subsidiary companies or securities in other companies. If the investments are those in a subsidiary company, they are fixed assets, and should be considered as other fixed assets, that is, not assets available for paying debts in the ordinary course of business, but only as possible sources of ultimate payment in case the business is liquidated. If the investments are stocks or bonds of other companies it is necessary to consider whether there is a ready mar-

ket for them, and what their present value is. If the securities are listed on an exchange and actively dealt in, they may be considered practically the equivalent of cash, subject, however, to variations in market value. On the other hand, if the securities are not readily saleable, they have little value for debt paying purposes, and the credit man should consider whether investing in them has not diverted too much capital from the business.

(d) *Insurance.* So important is the effect of insurance upon credit that the National Association of Credit Men has a special Committee on Fire Insurance, whose important duty it is, among others, to devise ways and means of inducing debtors to carry adequate insurance as a protection against fire losses. A comprehensive educational campaign has been carried on by the Association to show debtors the importance of carrying adequate fire insurance in sound insurance companies, and to show creditors the importance of advising all debtors to insure against fire.

A merchant may be a keen merchandising man, may have sterling character, and may have adequate capital invested in the business, but if he carries no fire insurance, all these may be insufficient in case of fire. The fire may destroy his entire stock and leave little for the payment of his creditors. In fact, numerous instances have occurred where the creditors were left practically nothing, and the debtor himself absolutely nothing with which to begin business anew and recuperate his losses. The merchant who does not carry adequate insurance is a dangerous risk; and before extending credit, the credit man should insist that

insurance be carried in sufficient amounts and in sound companies.

In connection with this item of fire insurance, it is well to note whether all the assets are fully covered. The fact that they are not may be due to one of two reasons: (1) the merchant may be careless in not protecting all his assets with insurance, or (2) the assets may be overstated in the financial statement.

A more recent step toward the protection of a business and its creditors is the insurance of the lives of officers of a corporation or members of a firm or even of the life of an individual proprietor for the benefit of the business. The death of an important member of a business often entails a great loss to the business. In some cases the success of the business depends on the activity of one individual. Certainly in the case of these "one man" concerns, life insurance should be carried to protect the creditors. In fact, some credit men refuse credit to such concerns, unless business life insurance is carried. Certainly, the carrying of business life insurance tends to strengthen the credit risk.

(e) *Accounts and Notes Payable*, past due. Does the proportion of past due accounts and notes indicate failure to take advantage of cash discounts? This is an important consideration, for in keenly competitive lines of business, the margin of profit is so small that the profits of the business depend largely on whether all discounts are taken advantage of. Moreover, if the quick assets appear ample to take care of the current liabilities, do the past due accounts payable mean that the assets are inflated? Or does it per-

haps signify that the accounts receivable are slow, merchandise selling poorly and cash needed for current expenses?

(f) *Mortgages and Bonds.* The due date of a mortgage is very important. A mortgage on property which has substantially depreciated may not be renewed and the results may be disastrous to all concerned. For illustration, a recent case may be cited. A manufacturer carried a heavy mortgage on property which, on account of the shifting of the business center, had depreciated materially. When the mortgage became due he was unable to renew it or to obtain another loan in its place. The mortgagee foreclosed. The property was sold for less than the amount of the mortgage and the mortgagee obtained a deficiency judgment against the manufacturer for the balance. Although the manufacturer's financial condition was otherwise not very strong, favorable business circumstances had previously warranted the belief that his affairs would take a turn for the better. But confronted with this sudden new demand his resources could not stand the pressure and he was forced into bankruptcy. Thus an apparent asset represented by the book equity of the investment in the real property was converted into a liability resulting in disastrous consequences. It can be readily understood, then, why it is of the utmost importance to know not only the gross value of the real estate, but also the amount and due date of the liens thereon.

(g) *Contingent Liabilities.* These are potential obligations becoming real only upon the happening of certain contingencies. Until such conditions arise the

debts are not chargeable and need not be included among the liabilities in the statement, but the existence of contingent liabilities should be disclosed in these supplementary remarks.

The contingent liability as guarantor or surety is that arising from the guarantees of the payment of another's account.¹ Until the person whose account is guaranteed has defaulted the guarantor has no present liability. To discover the possibility of default the credit man should investigate the circumstances surrounding the guarantee. The liability as guarantor or surety may also arise out of agreements, leases, pending law suits, etc.

The contingent liability as endorser arises when a merchant endorses his notes or bills receivable or "trade acceptances,"² which he has received, at his bank before their maturity. When these bills become due, the bank presents them to the maker, and if any of them are not honored, the merchant who discounted them must reimburse the bank. Of course, in turn, the merchant can collect from the maker of the paper provided the maker is responsible.³

*Accommodation Note.*⁴ Another way in which a merchant may become contingently liable is by endorsing a note for the accommodation or benefit of somebody else. In this case the endorser does not receive any of the proceeds of the discounted note. But if the person accommodated fails to pay the bank at

¹ See page 358, *post*.

² See page 21, *ante*.

³ See page 42, *ante*.

⁴ See page 44, *ante*.

maturity, the endorser becomes liable. Credit men should carefully investigate accommodation endorsements. The practice of two weaker concerns exchanging such accommodations may in the event of the failure of one force the failure of the other. This mode of financing should be discouraged.

(h) *Net Sales.* This information is necessary so that the credit man may ascertain, first, whether the volume of the business is commensurate with the capital employed; and, second, whether the stock is moving rapidly enough. The number of times the merchandise stock has been sold or turned over during the year is called the "turn-over." To ascertain the turn-over divide the average inventory at cost into the sales at cost. This turn-over will be found to vary in different lines of business. To illustrate, novelties must naturally be disposed of quicker than staples. Therefore, to determine the efficiency of a business from the "turning over" of its stock, a knowledge of the average turn-over in the line of business involved is necessary.

If the sales appear too large in proportion to the capital invested in the business, the inference may be drawn that the available capital is being overstrained. To check up the character of the sales and to substantiate the above inference, recourse must be had to the trade opinions to see whether the merchant's bills are being promptly paid. If they are not, the conclusion is obvious that the merchant is overextending credits and overtaxing his capital.

If the merchandise turn-over is below a fair average, either the inventory has been overvalued, too much

stock is being carried, or the inventory represents an accumulation of old stock, or the selling efficiency of the merchant is below the average.

It is well also to compare the net sales with the accounts receivable. If, considering the period of credit extended, the accounts receivable seem unduly large and out of proportion to sales, the probabilities are that many of the accounts are old and uncollectible.

(i) *Expenses.* In examining this item, the credit man should ask himself these questions: Is total expense too high in proportion to the sales? If so, does it mean too much overhead expenses? Is the rent excessive? In view of the volume of sales and gross profits, do the expenses indicate that the business is organized on an unprofitable basis? If the total seems to be too low, is it correct?

(j) *Profits.* This is an index of the efficiency of the capital. The result given here should be consistent with all other factors. If conditions in any given line were particularly depressed, making it practically impossible for any concern to have made money, and the concern shows a considerable gain, such a result in the face of adverse conditions will bear investigation.

(k, l, m) *Dividends.* This amount should be compared with the profits and the working capital as indicative of the policy of the corporation in paying dividends. Unless a sufficient portion of the profits is left in the business to reinforce its working capital, the dividend policy of the corporation may be looked upon with disfavor. In fact, the payment of divi-

dends, in the face of inadequate working capital, is a danger signal.

(n) *Incorporation, etc.* Owing to the lack of uniformity in the various state corporation laws, in order to be in the position to determine at any time the rights and obligations of the debtor, it is well to know under the laws of what state he is incorporated.

(o) *Secured creditors.* This is important to know for two reasons. First, any property which is pledged for the payment of one creditor will not be available for others. Second, the fact that the debtor must give security for credit obtained is an indication of weakness. Moreover, as a rule one creditor wants to be as well secured as other creditors.

(p) *Suits pending.* The mere fact that a debtor is being sued is not in itself sufficient to cause any alarm to creditors. For example, it is not unusual for a merchant to be sued by one of his employees for wages in dispute. It must be remembered that every one has a constitutional right to sue, and the mere bringing of the suit is not any evidence of the justice of the claim against the defendant. However, the credit man should investigate the nature of the suits, and see if any are brought by unpaid creditors to collect undisputed claims.

(q) *Inventory.* The reason for obtaining this information was discussed sufficiently under the analysis of the statement itself.

(r) *Books of Account.* It is instructive to know what books of account the debtor keeps in order to form an idea of the accounting methods employed in preparing the statement. This knowledge is also val-

uable in connection with any prosecution undertaken under the federal or state false statement laws, or, as will appear later, in case of the bankruptcy of the debtor.

(s) *Bank with.* The name of the debtor's bank should be obtained so that credit information concerning the debtor can be secured from it when necessary.

OTHER INFORMATION

In addition to the above the questionnaire usually calls for the names of the officers and directors, in the case of a corporation, or the names of the special and general partners, in the case of a partnership. Further investigation may then be made into the character of the individuals behind the concern. Moreover, it must not be forgotten, that in the case of a partnership, each general partner is individually, as well as jointly, liable for all the debts of the partnership. In case of insolvency, the creditors of the partnership can look, not only to the partnership assets, but also to all the assets of each general partner, except those specially exempted under the laws of the state. On the other hand, the special partners' liability is limited to the amount actually contributed to the business.

EXEMPTIONS

Under the laws of the several states, a debtor may hold a certain amount of his property immune from all liability for his debts. That is to say, property which is exempt under state laws cannot be attached

or otherwise levied on to satisfy the claims of creditors. Thus, real property, of not more than a certain value, occupied by a debtor as a residence for himself and family, is frequently exempted. Such exempt real property is called a homestead. Usually to have such property exempt, the debtor must record a claim of exemption in a public office. Household articles, wearing apparel and other goods or chattels of not more than a specified value are also often exempted from creditors' judgments. Of course, it is necessary for the creditor to know what exemptions the debtor claims, for the net worth of the debtor's estate, as far as creditors are concerned, is reduced to the extent of the exemption. For this reason it is especially important, in considering the financial statement of a debtor whose responsibility is limited, to know what part of the assets may be exempted by the state law.

THE ASSIGNMENT OF ACCOUNTS RECEIVABLE

The answer to the question (t) "Have you pledged or assigned any of the above accounts receivable of customers?" is vitally interesting to the credit man. The accounts receivable ordinarily constitute, after cash, the most liquid asset in the statement of a manufacturer or wholesaler. It is extremely important to know whether this asset is in any way encumbered or sold, so that its realizable value may be accurately estimated. The question (t) asked will produce this information.

The book account has a legal status. It may be

sold or mortgaged. The practice of raising money through the transfer of accounts receivable has assumed enormous proportions. In general, there are four ways in which money may be raised on accounts, or, as the expression is, accounts may be financed.

(1) Accounts receivable may be sold outright. The purchaser acquires the same right of action against the debtor as the original creditor had.

(2) Accounts may be discounted and guaranteed. Under this system the commission house or banker will advance funds covering a large percentage of the full net value of the invoices and insure the borrower against bad debt losses on such invoices. Charges are made for interest and also commissions to compensate for services rendered and the insurance feature. The difference between the net value of the invoice, less the amount of the commission and interest charges, less the amount advanced, represents the equity the assignor retains in the account. This is intended as a margin of safety to secure the assignee against reduction in the value of the invoice by reason of returned goods, claims or any other allowance, but not by reason of bad debt losses. Should the full amount be collected, or should no claims for returns or damaged goods be made, the assignor is paid the equity. If the equity proves insufficient the assignor must make good the deficit, but the banking house bears losses from bad debts. For this reason, all invoices are first approved by the credit department of the lender and the invoices are rendered by, marked payable to, and collected by, the banker. Time-honored institutions are engaged in this business and the

operations conform with high ethical standards. Full and thorough publicity is inherent in this system.

(3) Funds are advanced against unguaranteed assigned accounts under arrangements providing for the *notification of the debtor*. Notice is sent to all debtors whose accounts have been assigned and all subsequent invoices assigned are stamped with a notice to the debtor to the effect that the account has been assigned and is payable to the banker, whose name is given.

(4) Funds are advanced against unguaranteed accounts under agreements providing that the debtors of the assignor are not to be notified. This is commonly known as the *non-notification* plan.

It will be noted that the guarantee feature does not apply to either the third or the fourth systems discussed. In both these cases a percentage of the invoice value is advanced, the margin of safety depending upon the quality of the account and the standing of the borrower. If the proceeds of the assigned accounts do not satisfy in full the claim of the lender he has a right of action against the borrower for the unsatisfied balance. But, even though the accounts are not guaranteed, a commission or bonus is charged for services, in addition to a charge made for interest.

ADVANTAGES OF ASSIGNING ACCOUNTS

The assigning of book accounts has enabled the borrowers (1) to use advantageously the money received from the lender in making cash purchases and discounting their own bills, (2) profitably to increase their business, and (3) to obtain the required relief

when temporarily embarrassed owing to the unavailability of assets.

OBJECTIONS TO ASSIGNMENT OF ACCOUNTS

Several objections have been raised against borrowing funds on the assignment of open book accounts. These objections may be briefly summarized as follows:

First: The practice encourages unsound expansion of the borrowers' business. The borrower, in an effort to bolster up his sales and increase his profits, is inclined to increase his investment in fixed assets and to grant credit more freely. He does this, knowing that he can readily transfer his accounts and realize on them. Of course, if there turn out to be any losses later, he must bear them. The capable merchant, however, will look ahead and confine his business within safe limits.

Second: The companies which lend funds on the transfer of accounts charge excessively high rates, at least as compared with bank loaning rates. For example, the rates range up to more than thirty per cent, averaging more than fifteen per cent. But it is urged that the merchant, who can borrow money at 15% and discount his bills payable, saves money. This is true where the cash discount is as high as 2/10 net 30. If the discount rate is so high and the merchant cannot borrow money at his bank at 6%, he is probably justified in paying 15% for money he borrows in order to take advantage of his discounts. Only those merchants, however, who cannot borrow money from

a bank at 6% are justified in borrowing on the assignment of their accounts.

In many instances a debtor resorts to this plan of financing only when he is in a weakened condition and requires some ready cash to pay insistent creditors. Frequently the fees he must pay for the money borrowed are so excessive that they tend to precipitate the failure of the debtor.

Third: The practice makes possible and easy fraudulent manipulation on the part of dishonest debtors. Of course, the mere fact that an honest debtor resorts to this method of financing would hardly affect his honesty. But a dishonest debtor may pledge his accounts receivable and raise cash which he misappropriates, or uses to stimulate his credit by making prompt payments for a time to deceive his creditors.

The creditors (under the non-notification system) think the debtor is collecting his outstandings in the usual course and using the proceeds for paying his debts, whereas he is secretly assigning his accounts. Of course, if the creditor knew the debtor was thus financing his business, the credit man would know how to handle the situation. In fact he would probably not extend credit, except possibly on a ten-day cash discount basis.

As we have seen, the credit man, when determining the credit strength of the debtor, relies upon the accounts receivable as one of the most available assets. He is therefore entitled to know when the accounts are transferred so that he can form his own opinion as to whether in the particular instance such financing is in the interests of the business. Any plan designed

deliberately to withhold this information from him is deceitful and is a breeder of serious abuses. Thus, we find that the really serious objection to this plan of financing accounts, without notifying the debtors or creditors, is the secrecy of the system. Then, too, an important reason why this system is looked upon unfavorably by credit men is that when a debtor who assigned his accounts fails, as a general proposition, the estate is found in extremely wretched condition. The good accounts are usually transferred, leaving only the assets of inferior value for liquidation, and the dividends for the creditors are usually sub-normally low. This condition is made possible because the secret cashing of the accounts deceives the credit man as to the true condition of the debtor who is rapidly going down hill, even until the last moment.

To prevent a merchant from assigning his accounts secretly, vigorous efforts are now being made by the National Association of Credit Men and a number of its local branches to have laws enacted which will compel such a merchant (1) to register notice of the transfer of accounts in a public office, or (2) to give notice of the transfer to the debtors whose accounts have been transferred. If this is not done, it is provided that the transfer is to be void as against creditors.

COMPARATIVE STATEMENTS

If an exhaustive study of the balance sheet will accurately reflect the present condition, a comparison with the preceding statements will throw a strong light upon the tendencies of the business. From an

analysis of comparative statements it can be seen whether the business is going forward, standing still, or going backward. In comparing statements of different years, however, it is necessary to note, not only the change in the net worth of the business, but also the changes in the separate items. The present net worth may be larger, but the increase may be in fixed assets, in which case the business might not be in any better position. Possibly there may be an increase in the liabilities. This may result in a loss in the net worth. Or, if not, the corresponding increase may be in the fixed assets, in which case the business would be going backward.

The vital question is, Has the new relation of quick assets to quick liabilities increased or diminished the liquidity of the business? It is not the amount of the assets, but rather the fluidity of the condition, which denotes credit strength. If the business is going forward the *ratio* of quick assets to quick liabilities should increase. If the ratio is decreasing, even though the actual amount of quick assets over quick liabilities is increasing, the credit condition is becoming weaker. As an indicator of the trend of the business the value of comparative statements cannot be over-estimated.

THE HUMAN EQUATION

In considering the financial statement as a basis for credit the student will not be unmindful of the fact that the title to credit cannot be read entirely in the figures. Whose statement is it? What is his

character? Obviously, unless the debtor is trustworthy the statement is of little value. What are his habits? Is he a man of thrift, industry and stability? Is he a man of good business ability? How capable is he to use his resources? Is the business successful? Is the business well organized and well managed? Is the policy conservative or is it speculative? In brief, may the credit man be confident that the resources at the command of the business will be faithfully and efficiently used? Not in a few instances the debtor, soon after making a satisfactory showing, has been tempted hazardously to expand the business. The capital was thereby extremely strained and when the hoped for results did not materialize the business was exposed to serious consequences. It is the moral risk then that counts for more than anything else. "No statement is better than the man behind it," is an axiom well understood by credit men. *Character* and *Ability* are indispensable. Adequate working capital, however, is also required to establish a sound basis for *credit*.

CHAPTER XIV

COLLECTIONS

Prompt collections are a vital feature of every business. Irrespective of the size of the business, profits are dependent largely upon the number of times a merchant can turn over his capital, and frequent turn-overs can hardly be coupled with slow collections. No matter how large the volume of sales, the profits cannot be proportionately large, unless collections are promptly made. Then, too, slow collections cause a business to lose the use of its capital tied up in overdue outstanding accounts receivable. Laxity in enforcing prompt payments might also embarrass a house through lack of funds. Moreover, it might be unable to take advantage of discounts in paying bills.

Still another consequence of looseness in making prompt collections is the harmful influence on volume of sales. In all likelihood a debtor whose account is already overdue will not attempt nor will he be encouraged to place new current orders with that house. Prompt collections prevent the running up of a large overdue account. Not only these factors but also the psychology of demanding prompt payments must be considered by the credit department when extending credit and making collections. Most debtors respect a house which shows its accounts are closely watched

and promptly collected, and they will pay the accounts of such a house more readily than the accounts of a house which is lax and careless in demanding prompt payment. The aim of the credit department, then, should be to get the customers of the house to acquire the habit of making prompt payments.

CLASSES OF DELINQUENTS

The credit man who is successful in making prompt collections considers the collection of the account at the time of granting the credit. When he checks an order he anticipates the difficulties he may meet in collecting the account promptly, and prepares for them. Of course, every credit man prefers to have as many unquestionably good accounts as possible, but he is at times under a practical compulsion to check questionable accounts, for his function is not alone to keep down losses, but also to increase profitable sales. He must, therefore, accept many accounts that may prove difficult to collect. However, most of the accounts will be of the class which either "discount" or "pay just before" or "promptly at maturity," and which, therefore, require little or no attention.

The smaller group of debtors who do not meet their obligations promptly may be divided into three general classes:

First. Those who are able to pay, but negligently defer doing so and unfortunately require more or less urging.

Second. Those who do not intend to pay until forced.

Third. Those who through the happening of unforeseen contingencies over which they have no control find themselves obliged to postpone their payments.

Each of these classes of debtors requires different treatment. Generally speaking, the first class can be moved to pay by making the proper appeal and bringing into play the necessary pressure. The second class can be compelled to pay only through prompt and severe measures. A debtor in the third class will ordinarily pay as soon as he is in a position to do so. He should be assisted in every reasonable way until he is able to tide over his temporary embarrassment and regain his financial strength.

In view of the fact that each of these classes of debtors requires somewhat different handling, the credit man should determine as early as possible the reason for the delinquency. If the debtor is known as a chronically slow payer every effort should be made to impress upon him the wisdom and advisability of paying more promptly. At the same time care should be taken not to offend him so that his account will be lost, for many profitable accounts belong in this category. Drastic action, such as placing the account in the hands of an attorney, should be delayed as long as possible. This is especially true where the account is one of long standing. Where, however, the account is a new one, the credit man need not be so patient. And where the credit man suspects fraud or dishonesty on the part of the debtor, no time should be lost in forcibly demanding prompt payment.

COLLECTION SYSTEMS

While it is probably true that each account should be handled according to the merits of the individual case, nevertheless, where a credit or collection manager supervises the collection of several thousand accounts some kind of a system must be employed. Haphazard methods in following up a first statement usually result in carelessness and neglect on the part of the debtor in making remittances. Of course, the system adopted should be flexible enough so that in its operation due allowance will be made for differences in the financial condition, personality and past record of debtors. The system followed will depend, as a matter of policy, to a very large extent upon the kind of business in which the creditor house is engaged; for example, a house selling a widely advertised non-competitive product which is bought in small quantities by the retailer can be more or less arbitrary in demanding prompt payment.

THE MONTHLY STATEMENT

The first step in any system is the sending of a bill with the shipment of the goods. This is followed by sending statements. Many houses have adopted the plan of sending statements on the first of each month; those having items not yet due serve as a reminder that payment is expected when due; those having items past due are stamped with the words "past due, please remit," or similar words requesting payment. If after forwarding two or three monthly statements the ac-

count remains unpaid, these houses send a multi-graphed or personal letter calling attention to the state of the account and requesting immediate payment. These letters are followed up by drafts and various other devices known to the credit man and hereinafter described.

To careful collectors, the serious defects in this kind of a system must be obvious. If a debtor is negligent in making prompt remittances, surely this system will hardly accelerate his action. If a debtor is dishonest, this system will probably give the debtor the time he requires to complete any fraudulent scheme he may have devised.

A better system is one which is designed automatically to bring to the collector's notice daily such accounts as require his attention, having regard for the location and the credit standing of the debtor. Under such a system, the original bill itself might, in stating the terms, indicate the date when the bill is to become due. If monthly statements are sent to show the condition of the account, these statements might also indicate the date of maturity of each item. If bills are not paid before maturity, statements should be sent either two or three days before or immediately after the account becomes due. Statements sent before the bill is due serve as a reminder that the bill is becoming due, give the debtor an opportunity to check with reference to correctness and also forestall the possible excuse of the debtor that payment was overlooked. Statements sent immediately after the account is due serve as an indirect demand for payment. The effectiveness of these statements is possibly made stronger

by printing thereon a request for payment and the advice that past due items are subject to draft.

The procedure after these statements have been sent depends largely upon the nature of the account to be collected and the kind of business in which the selling house is engaged. Usually, after allowing sufficient time for a remittance in response to the statement, a brief formal letter is sent suggesting that the debtor has probably overlooked the account and politely demanding payment by return mail.

FOLLOW UP SYSTEMS

To facilitate following up this first letter in the collection of accounts various devices are employed. Some credit men, especially where the number of accounts is small, prefer to run through the ledger at regular intervals, possibly every week or every two weeks. This plan possesses the advantage of enabling the credit man to review the standing and record of each account and keep better posted on the development of an individual account. Further, under this system only one record of the account is made (i.e., in the ledger), thus avoiding duplications necessary under other systems. These advantages, at least where the number of accounts is considerable, are more than offset by the disadvantages of the system, namely:

First. It imposes on the credit man a good deal of unnecessary detail and mechanical work, consuming considerable time which might be spent to better advantage solving more difficult credit problems.

Second. The inspection of the ledger necessarily

causes interruption and delay to the work of the bookkeeper. Then, too, the credit man will usually find it necessary to go to another department to see the ledger. This invariably causes additional loss of time to both the credit man and the bookkeeper and may slightly disrupt the smooth running of the credit department.

Third. Statements are likely to be sent out haphazardly and at irregular intervals, for there is every incentive under this system to make this work of following up collections a matter secondary to the other duties of the credit man. Always awaiting an opportunity to go over the ledger, the credit man is likely to defer the actual inspection until all other matters are disposed of. The result is, collections are neglected and become slow and, eventually, difficult to collect.

THE TICKLER SYSTEM

To overcome these disadvantages, "tickler" systems supplementing the ledger have been used and found successful. There is wide variance in the details of these systems in use. The aim of any such system is to place before the credit man every day all past due accounts which require his attention. Thus he is saved the labor and time necessary to run through the ledger examining all accounts. The less duplication of records and the less clerical labor involved in doing this, the more desirable would be the system.

This result is usually accomplished by placing on a separate card the name of the debtor, the amount, the terms and date when due for each invoice. A

carbon of the original invoice will suffice for this purpose. These cards or carbons are then arranged, according to their maturities, in a tickler box, so that all those due on any one day will come up for attention that day. A clerk in the credit office can then go through these carbons, compare them with the ledger, discard those that have been paid, and send statements to the delinquent debtors. A notation that the statement was mailed is made on the carbon of the invoice, which is then advanced ahead in the tickler. This allows sufficient time for response from the debtor. If the account is not paid when the carbon reappears, the credit clerk writes a formal letter inquiring about the delinquency and requesting payment, at the same time making a note to that effect on the carbon and again advancing it in the tickler. Upon the next appearance of the carbon, if the invoice is not paid, the collection is referred to the credit man who treats the case as the occasion demands. If he draws on the debtor or writes another letter, a note is made on the carbon of the original invoice and it is returned to a position ahead in the tickler. Thus the tickler compels the attention of the credit man or his assistant to all past due accounts at *regular intervals*. It requires little labor to operate, saves the time of the credit man, and obviates the difficulties encountered in the ledger inspection system of following up collections.

THE USE OF DRAFTS

Where no response is had to the first letter many houses make a practice of attempting to collect the

debt by sending a draft on the debtor through the debtor's bank. Some houses prefer to send a draft immediately, if the account is not paid when due. Others defer the sending of a draft until it appears that the sending of statements and letters is productive of no good results. At what time a draft should be sent depends entirely on the custom of the trade and on the size and character of the account. In some lines of business it is the custom to draw on the debtor as soon as the account becomes due. On the other hand, in many lines the practice of sending a draft is looked upon as a somewhat drastic, if not unfriendly step, and may have an unfavorable effect upon the debtor.

Where a draft is used, it is either deposited in the creditor's own bank, which forwards it to a bank in the debtor's locality, or immediately sent by the creditor to a bank in the customer's vicinity. Many credit men find it profitable to make a notation on their ledgers of the name of the debtor's bank, as ascertained from checks sent by the debtor; and when a draft is used to forward it to this bank. The psychological effect on the debtor of presenting a draft through his own bank is often productive of good results. In other cases the name of the bank in the customer's locality is obtained from one of the mercantile agency books or law lists, which usually include a list of banks. Many banks will present these drafts to the debtor free of charge, unless collected, in which case an exchange charge is made. However, the general use of drafts which are returned unpaid has imposed such a burden on banks that many banks will

not give careful attention to the presentation and return of the drafts unless a small fee of at least ten cents is sent with the draft. It is probably a better practice for the credit man to enclose this fee with the draft, together with polite instructions to the bank as to presenting the draft and holding it for payment, with the additional request to remit the proceeds, if collected.

At the time the draft is sent to the bank, a letter should be written to the debtor advising him of this fact so that he will be prepared to meet the draft when it is presented. This letter should intimate that probably the debtor prefers to make payment in this manner and suggest that he take steps to meet the draft.

Formerly, a draft, if not honored, menaced the debtor's credit; in fact, at one time to dishonor a draft was a virtual confession of insolvency. But under business practice of to-day a different significance is attached to this action, and drafts are returned now with little, if any, misgiving. Of course, were a debtor consistently to return all drafts on him, assuming they were numerous, his actions would soon depress his credit standing, especially at the local bank. On the other hand, the action of the debtor in not honoring the draft should not cause the credit man any unusual anxiety. Some debtors may be temporarily out of funds, others may resent the sending of the draft and show their resentment by paying no attention to it, while still others, considering the draft a reflection on their credit, prefer to remit by other means. Then, too, the bank may have been negligent in presenting the draft.

THE INDORSEMENT

When a draft is not honored, it is returned to the drawer (creditor) with a notation or indorsement giving a brief reason for the debtor's failure to pay. These notations sometimes give the creditor an insight into the debtor's intentions as to paying the debt, and furnish the creditor a better basis for the future handling of the account. If the indorsement indicates that no attention was paid to the draft by the debtor, or that the debtor was unprepared at the time to meet the draft, a second draft might be sent immediately, together with a letter referring to the first draft and suggesting that the debtor be ready to take up the second draft so that there will be no reflection on his credit.

If the second draft is returned with the same notation immediate steps should be taken to protect the account. A telegram or night letter expressing surprise and requesting an immediate explanation has often been found effective. If no response is had to the telegram, more drastic measures must be taken.

If the draft comes back with some other endorsement, the credit man should base his next letter on the reason given by the debtor for not paying. The kind of letter and the subsequent steps will depend on the peculiar conditions affecting the account.

COLLECTION CORRESPONDENCE

Although it is true that the character of the letter written to collect an account should be adjusted to meet the requirements of each individual case, there

are a few fundamental principles regarding collection correspondence which the credit man should bear in mind. The successful correspondent puts himself in the debtor's place, and tries to imagine what the debtor will do under the circumstances. He studies the debtor's mental attitude, and, by so doing, he ascertains what kind of a collection appeal will be the most successful. All appeals should be straightforward and honest. It is never worth while to apologize or to invent excuses when calling upon a debtor to pay. The credit man who bases his appeal on the ground that his firm has some large obligations to meet usually gains the disrespect of the debtor. The average debtor believes either that the reason given is fictitious or that the creditor is in a tight position, and in either case the creditor usually gains nothing.

The credit man wants the debtor to pay because the money is owing and because he confidently expects the debtor will meet his obligations. If the debtor cannot pay when the bill is due, the credit man is entitled to a reason; and no extension of time should be taken by the debtor without the creditor's consent. Of course, if the debtor can give some good reason for being unable to pay promptly, the credit man should be ready to grant a reasonable extension and to treat the debtor equitably. When granting an extension the credit man should always fix a definite future date on which payment is to be made, and the debtor should understand that payment is expected no later than that time. One of the advantages of granting an extension is that it usually affords the credit man an opportunity

to obtain from the debtor a late financial statement and other valuable credit information.

Another fundamental principle is that the credit man who can make the debtor feel that the account ought to be paid has a splendid chance to get his money quickly. This can sometimes be accomplished by appealing to the debtor's pride in his business honor or to his anxiety as to his credit standing. Then, too, the assumption of a friendly and ready to help attitude usually wins the good will and confidence of the debtor and paves an easy way for obtaining payments. To accomplish this, dignity and firmness need not be sacrificed.

ACTUAL PROCEDURE

The actual procedure in any particular case, as we have previously pointed out, depends largely on the situation of the customer. Let us assume that a debtor is in fair condition and apparently has the confidence of the trade. In such a case a statement is sent a few days after the bill is due. After allowing a reasonable time for reply, a letter, similar to the following, could be sent.

"Enclosed you will find a duplicate statement of your account, which became due on —.

"No doubt our previous statement must have escaped your attention, or it may be that a check is already on the way."

If no answer were received to the above within reasonable mailing time, a second letter could be sent, as follows:

"We are quite surprised that you have allowed the enclosed past due account to remain unpaid. It will be to our mutual advantage for you to send a check by return mail. In any event, we shall look forward to hearing from you within the next few days."

If this letter brings no response, the next step might be to draw on the customer and, at the same time, to write a letter of the following tenor:

"We have written you twice about the enclosed account, and, somewhat to our surprise, have heard nothing from you.

"Probably you prefer to pay this item by having us draw on you. Acting on this assumption, which we trust is correct, we are depositing a draft in our bank which will be presented to you in due course.

"Will you kindly be prepared to pay this draft when you receive it."

If the draft is returned unpaid, and no word is received from the debtor, the next letter, which should be based on the notation on the returned draft, might be along the following lines:

"We are really at a loss to understand the reason for your failure either to answer our letters about the payment of enclosed account or to pay our recent draft, which was returned endorsed, 'Cannot pay now.' We sincerely hope that this does not mean that you are meeting with any difficulties in your business. However, if this should be the case,

you can depend on us to co-operate with you in every reasonable manner possible. If you feel that you require a further extension of time to meet this bill, do not hesitate to place before us the entire facts.

"On the other hand, if you are in a position to do so, we trust that you will send a check immediately. When we checked through your order, we confidently expected you would pay the bill, as you had agreed, as soon as it became due, unless, of course, unforeseen contingencies should arise. To disregard the obligation imposed on you by the terms of our agreement, without offering any reason therefor, is bound to reflect on your credit standing.

"We want you to feel that you can at all times rely on our co-operation and fair treatment, and we confidently expect the same of you. A prompt response from you will help avoid any further misunderstanding."

Probably in most cases the above correspondence would have elicited some response from the debtor; but if no answer is received to the last letter, the credit man should, in taking the next step, be governed by his knowledge of the standing of the debtor, as reflected by his own experience and the credit reports. If necessary the credit information should be brought up to date. In seeking information at this time, however, discretion should be exercised to avoid unduly exciting apprehension among other creditors. It may be timely now to draw a report from the local attorney. The attorney should be asked specifically if any

suits have been filed against the debtor. The knowledge gained from this investigation will enable the credit man to plan intelligently the future treatment of the account.

Assuming the investigation brings to light no unusual developments, a letter, insisting upon payment, could be written somewhat in the following fashion:

"You have apparently paid no attention to our last letter, nor to several that preceded it, about the enclosed account. Frankly, we cannot understand why you have failed to reply to these letters, for surely you must realize how seriously this reflects upon your credit standing.

"We sincerely hope that you will not compel us to take any further steps to collect this account. At the same time you must know that it is not good business policy for any house to continue writing letters indefinitely; and the account is now so long past due that we must insist upon hearing from you by return mail."

Following this letter by a telegram is often effective. Such a telegram might read:

"Are you remitting. Must have your answer immediately."

The next letter should warn the debtor that unless the account is paid more severe measures will be taken or that the account will be placed in the hands of an attorney. However, a threat to call upon an attorney should never be made unless there is every intention to carry out the threat. Nor should this step be taken

until every other effort to collect has failed and the creditor is prepared to sever all business relations with the debtor.

Before writing a letter of this character, if the account is large enough and a previously valued one, and if the debtor's location is not too far distant, more satisfactory results may often be obtained by making a personal visit to the debtor's place of business. A full explanation of the reason for the delinquency can be procured more easily, an investigation into the debtor's affairs made, payment obtained, the confidence of the debtor won, and possibly a satisfactory basis for the continuation of business relations arranged. These results could hardly be expected, even by the most optimistic credit man, from any other method of procedure.

If a personal call is found impracticable, a letter along the following lines could be sent.

"On —, we sent you the following telegram, 'Are you remitting? Must have your answer immediately.' You have seen fit to ignore this telegram as well as the many letters we have sent you about your account.

"You will agree with us in the belief that we have been very lenient and patient with you. However, under the circumstances we cannot possibly carry your account any longer, and you leave us no choice but to turn this account over to our attorneys for collection.

"This is a step that we have delayed as long as possible, in the hope that you would realize the

gravity and danger of such an action being taken, and the unfavorable effect this would have on your credit standing. We sincerely hope that, for your own good, you will not compel us to take any further action.

"However, unless a remittance is received from you before — we shall be obliged, much against our own wishes, to place the account in the hands of our attorney."

If no remittance is forthcoming by the date mentioned in the above letter, the creditor should not delay in carrying out the threat made. This might be done either by turning the account directly over to an attorney or by drawing on the debtor and sending the draft to a local bank, with instructions to turn the draft over to a local attorney in case it is not paid. At the same time the local attorney should be informed of the circumstances and instructed what to do if the draft is referred to him. The debtor should also be advised of what is being done, and informed that unless the draft is honored the account will automatically be turned over to an attorney.

Drafts issued by certain collection agencies and law list publishers are very useful for this purpose. These drafts have attached to them stubs instructing the bank to hand the draft to an attorney named on the stub if the draft is not paid. This has the advantage of compelling the debtor's attention to the fact that unless he pays, the threatened action will be carried out. He also realizes that the attention of the local bank has been directed to the situation, with the pos-

SUBJECT: DRAFT ON _____

OF _____

We take the name of your Draft, and the
"United States Fidelity and Guaranty Company,"
Baltimore, Md.

INSTRUCTIONS TO BANK
(To be used by letter transmittal)

Gentlemen: If attached draft on the debtor named herein is paid at maturity, PLEASE REMIT PROCEEDS
DIRECT TO THE UNDERSIGNED.

IF NOT PAID, please promptly deliver or mail same to enclosed stamped and addressed envelope to
the attorney named below. DO NOT PROTEST.

\$ _____

WITH CURRENT EXCHANGE. Holding Bond of the U. S. F. and G. Co.

BANK WILL PLEASE TRANSMIT.

LETTER OF ADVICE TO ATTORNEY,
Notifying a Holder of the Bond of the United States Fidelity and Guaranty Company.

To _____

Address _____


Dear Sir:—Payment of annexed Draft having been refused, you are hereby authorized to take
prompt action for its collection on the terms stipulated on the back hereof. Promptly acknowledge receipt
and advise what course is best to pursue. Write, if in your opinion the circumstances warrant.
Respectfully,

REMIT ALL MONEYS COLLECTED
BY P. O. MONEY ORDER, BANK
EXCHANGE OR EXPRESS.

Address _____

Holding Bond of United States Fidelity and Guaranty Co.,
Baltimore, Md.

DO NOT DETACH FROM DRAFT.

 **DRAFT OF A HOLDER OF THE BOND OF THE**
UNITED STATES FIDELITY AND GUARANTY COMPANY'S
DEPARTMENT OF GUARANTEED ATTORNEYS.
Total Resources, Over \$6,000,000. Home Office, BALTIMORE, MD.

\$ _____

WITH CURRENT EXCHANGE.

At _____ sight, Pay to the order of the _____ Bank of _____

the sum of _____ Dollars,

Value received and charge to account of _____

To _____

DESTROY.

Address _____

Holding Bond of United States Fidelity and Guaranty Co.,
Baltimore, Md.

U. S. Form No. 1001. 7

PATENTED IN THE U. S. JULY 21, 1914.

sible result that his local credit will be seriously im-
paired. The debtor who wishes to avoid either of
these unpleasant results will honor the draft.

On the other hand, there are some serious objec-
tions to informing the local bank of the delinquency

of the debtor and the necessity for drastic action. Frequently, whether or not any one creditor will be able to collect depends largely upon the other creditors' general knowledge of the debtor's weak condition. This knowledge is quite certain to become more general by calling the attention of the bank to the debtor's weakness. This may result in numerous demands for payment and a shutting off of the debtor's credit by the bank and other creditors, only to precipitate the insolvency or bankruptcy of the debtor. For his own interests, the creditor desires to avoid such consequences, and will hesitate to direct the bank's attention to the condition of the debtor's account, especially where the amount is very large. Probably in such a case it would be better for the creditor to get in direct touch with the local attorney. The attorney can then investigate the situation, have a conference with the debtor and advise the course of action to be taken.

WEAK DEBTORS

If, during the course of the above correspondence, the creditor discovers that the debtor is in a comparatively weak condition, but apparently has the confidence of the trade, drastic action should not be taken. This is especially true where a large sum is owing to the creditor. By exercising patience, and extending an additional small line of credit so that the debtor can replenish his stock, the creditor may find everything will turn out satisfactorily. However, no such course should be followed until the debtor has fully and frankly disclosed his affairs to the creditor, and unless

there is every evidence of *character* and capacity, and a sufficient basis of hope for the recovery of the debtor. If in such a case the creditor were to insist on payment, the downfall of the debtor might be precipitated, with the usual result of bankruptcy and a few cents on the dollar for the creditor. Contrasted with this, if the creditor is forbearing and supplies the debtor with more merchandise, risking a few dollars more, the debtor who possesses character and capacity has a good chance to recover, with profit to himself and his creditors. The creditor, farsighted enough to follow this course, will be paid in full, and further will gain the good will and future business of the debtor. Excellent judgment must be exercised, however, to avoid "throwing good money after bad."

Where, on the other hand, the customer is found to be in bad financial condition, going backward and losing the confidence of the trade, and there are other earmarks of an unavoidable failure present, the creditor should pursue quite a different course. Where these conditions exist, it is found that the debtor's credit is being shut off in many quarters, and, needing certain merchandise, the debtor is paying cash for some of his supplies. Moreover, in a final effort to stave off the inevitable failure, such a debtor invariably pays the most insistent creditors. Under these circumstances strenuously to insist upon payment is the most practical course for the creditor to take. Many of the letters and steps suggested in the procedure outlined above should be eliminated and the issue immediately forced, though it is found necessary to place the account for collection without much delay.

NOTES

When a debtor offers to pay his past due account by note, there are several questions for the creditor to consider before accepting the note in settlement. There are possibly three arguments in favor of the note. First, a note serves as practically conclusive evidence of the debt and facilitates proof in case it is subsequently necessary to sue the debtor. Second, a debtor may consider a note a more solemn obligation than the open account. He realizes, for example, that a note may be discounted at a bank and presented by the bank. For this reason, he may be more apt to be prepared to meet the note than to pay on the open account on any fixed date. Third, a note may be more easily transferred and realized on by the creditor.

The soundness of the last two arguments is seriously and probably correctly questioned by many credit grantors, who offer a number of important objections to the acceptance of a note in payment of a past due account. These objections may be catalogued as follows:

First. A note, especially of a retailer, is not always paid when due; and usually the debtor offers to pay only part of the note on its due date, tendering another note for the balance.

Second. Ordinarily the open account is paid more promptly than the note or its renewals, especially where part payments are accepted from time to time on the open account.

Third. For a creditor to accept a note serves as a very bad precedent. As a rule, when several notes

have been accepted by a creditor, he will find it difficult to obtain any other form of payment from the debtor.

Fourth. The creditor, by accepting a note, waives all right to expect or demand payment until the due date of the note. In case any immediate action, such as the bringing of a lawsuit to enforce payment, were considered desirable, the creditor would have to postpone this action until after the note became due.

Fifth. By refusing to accept a note, the creditor can often gain the good will and esteem of the debtor, for the debtor is very gratified to be led to believe that this refusal shows greater confidence in him.

All of these objections should be considered by the creditor before he accepts a debtor's note. Probably it is usually better for the creditor to allow the debtor to make payments from time to time on the open account. If, however, a note is thought to be more desirable, better results may be obtained by employing an installment note, which provides for the payment of small amounts from time to time, on condition, however, that the entire amount shall become due and payable in case of default of any installment. Wherever possible, the creditor should have the debtor procure some responsible party as endorser for the note. This adds considerably to the creditor's security, and makes the payment of the note much more certain.

ATTORNEYS

As we have previously mentioned, an account should not be placed in an attorney's hands for collection until

all other means have been exhausted and unless the creditor is prepared to sever his business relations with the debtor. At the same time, it is well to remember that the older an account becomes, the more difficult it is to collect, and for that reason, when circumstances warrant, the creditor should not hesitate to seek legal redress.

When an account is given to an attorney, he should be instructed to proceed promptly and vigorously in an attempt to collect without suit. Where the attorney succeeds in obtaining payment without suit, a charge of usually 10% is made for sums up to approximately three hundred dollars and for larger sums a proportionately smaller charge is made. The bringing of a lawsuit adds considerably to the expense involved, so that if the circumstances warrant it, the attorney should make every reasonable effort to collect before filing a suit. It is, in many cases, better to accept installments from the debtor than to bring suit.

A good collection attorney will acknowledge the receipt of the claim as soon as it is received by him. He will then immediately attempt to settle the case without going to law. If this is impossible he will advise the creditor whether or not a suit is expedient, depending largely upon the probability of proving the claim and of collecting any judgment which might be obtained. Through sundry devices, various debtors render themselves "judgment proof," and it would be obviously unwise to go to the expense of suing them. Then, too, the debtor may have either a large counterclaim for damages or a valid defense to the action,

or there may be too many difficulties in the way of proof.

Good collection attorneys, however, are not always available; in many small western and southern communities it is almost impossible to obtain satisfactory results from local attorneys. Very frequently these attorneys are neighbors and friends of the debtor, and their efforts to collect consist largely of making casual remarks about the debt to the debtor. In such cases, it is always better to engage an attorney living in an adjacent larger town or city. Other attorneys, lacking any semblance of office system, are wont to allow a claim to drag along without taking any aggressive steps to collect, and it is necessary for the credit man to keep everlastingly after these attorneys in an effort to get regular reports about the progress of the collection.

The question naturally arises, How is the credit man to obtain the names of attorneys who have the ability to collect and who will be responsible for any money collected? To aid the credit man in the selection of such an attorney several concerns publish lists of lawyers, which we have previously mentioned in the chapter on Sources of Information. Some of these publishing concerns stand responsible for any claims collected by any attorney listed in the book, provided the creditor notifies the publisher of the list or otherwise complies with the requirements of the publisher. These lists are referred to as "bonded attorney lists" or "guaranteed attorney lists." The publishers of some of these lists go so far as to rate each attorney in the book according to his estimated financial worth, char-

acter, legal ability and promptness in paying claims collected.

While the publishers of these lists make every effort to select attorneys who will be satisfactory to creditors in the collection of claims, there is no assurance that these attorneys will perform their work promptly and efficiently. Therefore, many credit men, especially in the larger houses, compile their own lists of attorneys. The names, in such a case, are usually first obtained from the various law lists, and subsequently investigated as to character and capacity as thoroughly as the ordinary credit seeker is investigated.

FORWARDING LAWYERS

Some credit men prefer to place all claims in the hands of one lawyer located in the same city. This lawyer, who is usually a specialist in handling collections, then forwards the claim to a correspondent attorney in the locality of the debtor. The fee in this case, which is no larger than where the claim is sent direct, is divided between the two attorneys, the forwarding lawyer retaining usually one-third.

The advantages set forth for this plan are twofold. First, the creditor is relieved of the necessity of constantly prodding the distant attorney, for the first lawyer usually has a carefully planned system to follow up the status of the collection. This, however, is true to a very limited extent, for the credit man is anxious to keep informed as to the progress of the account and, therefore, will correspond continually with the first lawyer. This in reality necessitates a

duplication of correspondence. In the second place, it is contended that the lawyer, because he has occasion to forward more claims for collection than the average creditor, is in a better position to become more familiar with the ability of the correspondent attorneys. Therefore, it is argued, more satisfactory service may be had. On the other hand, it is claimed that the correspondent attorney will not give as close attention to the claim, because he must divide his fee with the forwarding lawyer.

COLLECTION AGENCIES

Many credit men prefer to utilize the services of a collection agency in place of a local lawyer. The agencies, before forwarding an account to its correspondent attorney, usually write a series of letters demanding payment. In other respects their work of collecting an account is very similar to that of the local lawyer, and many of the same arguments in favor of and against their use apply. Probably most of the agencies are more systematic than lawyers in following up a collection. However, there are literally thousands of irresponsible collection agencies, and a credit man should thoroughly investigate an agency or, if necessary, require a bond to cover the amount of the claim before placing an account in its hands for collection. In dealing with the larger, well established agencies, the credit man need have no apprehension about the responsibility. Another argument in favor of the large agencies and trade bureaus is the powerful moral effect on the debtor. The average debtor

THE ASSOCIATION OF BONDED ATTORNEYS

Home Office: Milwaukee, Wisconsin

AN ASSOCIATION OF MERCHANTS AND ATTORNEYS ORGANIZED FOR THE PROTECTION OF CREDITORS

To.....191..
.....

The undersigned is a member of the above Association and enjoys its fullest protection. Under the terms of membership it is required that all claims against delinquent debtors be placed in the hands of local attorneys for prompt and vigorous action. Your immediate remittance direct to us of the amount of your now overdue ^{note} _{acct.}, which ^{without} _{with} interest is \$....., will render it unnecessary to place this claim with the Association's attorney in your town.

Respectfully yours,

REPLY MUST COME BY RETURN MAIL TO

DUNNING FORM No. 1

THE ASSOCIATION OF BONDED ATTORNEYS

Home Office: Milwaukee, Wisconsin

AN ASSOCIATION OF MERCHANTS AND ATTORNEYS ORGANIZED FOR THE PROTECTION OF CREDITORS

To.....191..
.....

Under the regulations of the above Association, a second and final notice is hereby given you that, unless remittance be made immediately, direct to us, in payment of your past due account, the claim will be given to local attorneys in your town for collection. The requirements of the Association render it imperative that no indulgence be granted by its attorneys, so you will save trouble and expense by immediate payment. PLEASE REMIT \$.....IN FULL PAY-

MENT BY RETURN MAIL TO

Yours truly,

DUNNING FORM No. 2

knows that if he fails to pay an account placed in the hands of one of these agencies the entire business community may learn of it and his credit will consequently suffer. For that reason the debtor is apt to make every effort to meet the claim. On the other hand, it may be reasoned by the creditor that to have this information concerning a debtor passed on to other creditors would endanger the account and materially weaken the possibility of collecting it.

COLLECTION AGENCY FORMS

Many collection agencies, law list publishers, trade organizations, and collection letter concerns have devised a series of blank forms or "collection letters." These forms, which bear the name of the agency, are

Established 1868	Incorporated 1891
General Offices, Woolworth Building, New York	
THE MARTINDALE MERCANTILE AGENCY	
To.....	
Dear Sir: Please remit direct to the undersigned, or call on them and settle (<small>NOTE OR</small>)..... <small>BILL</small>	
amounting at present date (principal and interest) to \$	
By settling this at once you will save us the trouble, and yourself the expense and embarrassment of having it placed in the hands of our Attorney.	
Signed.....	
Subscriber to the Martindale Mercantile Agency	
Street and No. { City {	
Date.....19....	

sold or given to creditors, who, when the occasion arises, fill in the blanks and send them to delinquent debtors. The intention is to impress the debtor with the idea that these blanks are sent by the agency, and

Collection Letter of a holder of the bond of the
UNITED STATES FIDELITY AND GUARANTY
COMPANY

ISSUED BY THE DEPARTMENT OF GUARANTEED ATTORNEYS,
Home Office, Baltimore, Md.

JOHN R. BLAND, Pres.

Capital paid in cash, \$2,000,000.

Total resources, over \$8,750,000.

To.....19

The amount of your overdue { note } { with }
account { without }
interest is \$.....

The undersigned begs to advise that immediate settlement will obviate the necessity of placing this claim for prompt action in the hands of an Attorney who will, on our notice, be covered by the bond of the United States Fidelity and Guaranty Company, which we hold.

.....
Holding bond of United States
Fidelity and Guaranty Company

No.Street

.....
City State

that unless payment is received immediately, more drastic action is to be expected.

These forms recommend themselves to many credit men on account of the lack of expense and work in using them. However, they should be used only as an alternative or preliminary step to sending an account

to an attorney. Their use should be deferred until all other means for collecting the account have been exhausted. In fact, these blanks are not the most satisfactory form in which to demand payment unless the account is thought undesirable and unless the creditor is prepared to sever business relations with the debtor. In general it is usually well to avoid form letters, that is to say, printed or mimeographed letters, for their use suggests either a lack of serious interest in the debtor, or that slow payments are not unusual. Of course, no creditor desires to create either of these impressions.

SPECIAL PROBLEMS IN COLLECTIONS

In the work of collecting accounts, the credit man must decide some difficult questions of business policy and at times overcome many tricks resorted to by some debtors. For example, there is the question of whether or not interest should be charged on past due accounts. What should be done when the debtor takes excessive or unearned discounts off the face amount of the bill? How should an unsigned or defective check sent by the debtor be handled? Each of these questions is worthy of serious consideration.

INTEREST ON PAST DUE ITEMS

There can be no question but that there is every justification for charging interest on accounts which run past the date of maturity. Definite terms are fixed at the time the sale is consummated. The seller ex-

pects to receive payment on or before the due date, and with this in mind he determines prices. If the purchaser does not pay when the bill is due, the seller loses interest on the amount outstanding and his profits suffer. In reality, by holding on to the money after the account becomes due, the debtor is borrowing money from the creditor without the creditor's consent. If the debtor borrowed money elsewhere he would have to pay interest, and if the creditor loaned his funds elsewhere he would receive interest. Certainly, then, the debtor should be required to pay interest on past due items.

To view this question from another angle, if the creditor were not to charge interest he would be discriminating between customers, and treating the prompt payers unfairly. The customer who pays his bills promptly often finds it necessary to borrow money from his banker in order to be prompt. Another customer, who, instead of borrowing the money at his bank, compels the seller to carry his account, is buying his merchandise cheaper than the prompt paying customer to the extent of the interest he would have to pay the bank. If then the creditor does not charge interest, the "prompt pay" customer suffers a serious disadvantage, and a premium is placed upon slowness. In justice to all concerned, interest on past due accounts must be charged.

COLLECTING INTEREST

Many houses find they are able to collect interest by printing on all statements words to the effect that in-

terest is charged on all past due accounts, and by actually adding the interest to the amount of the invoice on statements of past due items. Other houses simply attach a printed sticker to past due statements, and in case interest is not included in the remittance from the debtor a bill for interest is sent. Some houses have found that calling the attention of the customer to the fact that he will save interest by remitting promptly has stimulated more prompt payment.

THE UNEARNED DISCOUNT ABUSE

Another serious question with which credit men have to deal is the unearned discount evil. As we have previously explained in the chapter on Mercantile Credit, cash discount is a premium given to the debtor for payment within a certain time, usually within ten days after the date of the invoice. The debtor is entitled to this discount only when he remits within the specified time. Nevertheless, there are many debtors who remit from ten to sixty days after the discount period has elapsed and who then have the audacity to deduct the discount. On this question of unfairly deducting discounts we quote a leaflet of the National Association of Credit Men.

Any strain unnecessarily imposed upon the sound and reciprocal relationship that should exist between the buyer and seller of commodities is a direct violence upon the good order and safety of business. One of the most common causes of strain is that imposed by buyers in deducting, at the time of set-

The creditor should tactfully but firmly insist that the debtor live up to the terms of sale. Whenever a check, with the unearned discount deducted, is received before the maturity of the invoice, probably the best practice for the creditor to follow is to return the check, so that the debtor will have the privilege of waiting until the due date of the bill to remit without deducting a discount. When, however, the check with discount deducted is received after the maturity of the invoice, the creditor has his option of returning the check or retaining it and sending a bill for the discount unjustly deducted.

DEFECTIVE REMITTANCES

Sometimes a debtor sends a remittance which is defective in one way or other; possibly the check will be for an incorrect amount, or unsigned or omitted altogether. This may be due to an honest mistake, or it may be an attempt on the part of a scheming debtor to delay payment a little longer. In either event the credit man can so handle the remittance as to remedy the mistake or to prevent the wrongful delay without incurring the displeasure of the debtor. For example, where the debtor's signature is missing from the check, it would be proper for the creditor to deposit the check and guarantee the signature, at the same time writing the debtor of what has been done. Or, if the check is for an incorrect amount, the creditor might insert the correct amount, and guarantee it when the check is deposited, immediately advising the debtor.

In case the check is not enclosed in a letter which

purports to contain a check, the creditor, especially where he believes the omission was intentional, could draw on the debtor, notifying him that this was done as the most convenient way of remedying the error. In any event, the credit man should be exceedingly tactful and diplomatic in handling these problems, for by one inappropriate statement or move a valuable customer may be lost.

CHAPTER XV

LEGAL REMEDIES OF THE CREDITOR

UNPAID SELLER'S LIEN

When merchandise is sold without any agreement for an extension of credit to the purchaser, the seller has a lien for the purchase price. That is to say, the vendor need not part with the merchandise until the price is paid him. And this is true even though title or ownership in the goods has already passed to the vendee. Moreover, the seller has a lien even where the merchandise has been sold on credit, if the buyer becomes apparently insolvent and the goods sold or part of them are still in the custody of the vendor. This rests on the theory that though the vendor, by giving credit, waives his lien for the price, he does so on the implied condition that the purchaser keep his credit good.

The Uniform Sales Act, which has been enacted in many of the United States, sets forth the general principles governing the unpaid seller's lien in very clear and instructive language. Sections 54 to 56 of the act provide:

WHEN RIGHT MAY BE EXERCISED

(1) Subject to the provisions of this act, the unpaid seller of goods who is in possession of them is entitled

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to retain possession of them until payment or tender of the price in the following cases, namely :

(a) Where the goods have been sold without any stipulation as to credit ;

(b) Where the goods have been sold on credit, but the term of credit has expired ;

(c) Where the buyer becomes insolvent.

(2) The seller may exercise his right of lien notwithstanding that he is in possession of the goods as agent or bailee for the buyer.

LIEN AFTER PART DELIVERY

Where an unpaid seller has made part delivery of the goods, he may exercise his right of lien on the remainder, unless such part delivery has been made under such circumstances as to show an intent to waive the lien or right of retention.

WHEN LIEN IS LOST

(1) The unpaid seller of goods loses his lien thereon,—

(a) When he delivers the goods to a carrier or other bailee for the purpose of transmission to the buyer without reserving the property in the goods or the right to the possession thereof ;

(b) When the buyer or his agent lawfully obtains possession of the goods ;

(c) By waiver thereof.

(2) The unpaid seller of goods, having a lien

thereon, does not lose his lien by reason only that he has obtained judgment or decree for the price of the goods.

STOPPAGE IN TRANSITU

It sometimes happens that a seller, who has sent goods to a buyer at a distance, after sending them finds that the buyer is insolvent. Under such circumstances the seller may stop the goods at any time before they reach the buyer. His right to do this is called the right of stoppage *in transitu*.¹

It is important to note that this right exists while the goods are in the hands of a carrier or middleman on their way to the buyer, and continues not only while the goods are in actual transit, but until they have reached their destination and are delivered into the actual or constructive possession of the consignee. The mere unloading of the goods and placing them in the warehouse of the transportation agency does not necessarily end the period of transit or terminate the vendor's right of stoppage in transitu. This right con-

¹ The Uniform Sales Act, which has been enacted in many states, provides: *Seller may stop goods on buyer's insolvency.*—Subject to the provisions of this act, when the buyer of goods is or becomes insolvent, the unpaid seller who has parted with the possession of the goods has the right of stopping them in transitu, that is to say, he may resume possession of the goods at any time while they are in transit, and he will then become entitled to the same rights in regard to the goods as he would have had if he had never parted with the possession.

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tinues as long as the goods remain in the hands of the carrier as such.¹

¹ Section 58 of the Uniform Sales Act provides: (1) Goods are in transit within the meaning of section 57,

(a) From the time when they are delivered to a carrier by land or water, or other bailee for the purpose of transmission to the buyer, until the buyer, or his agent in that behalf, takes delivery of them from such carrier or other bailee;

(b) If the goods are rejected by the buyer, and the carrier or other bailee continues in possession of them, even if the seller has refused to receive them back.

(2) Goods are no longer in transit within the meaning of section 57,

(a) If the buyer, or his agent in that behalf, obtains delivery of the goods before their arrival at the appointed destination;

(b) If, after the arrival of the goods at the appointed destination, the carrier or other bailee acknowledges to the buyer or his agent that he holds the goods on his behalf and continues in possession of them as bailee for the buyer or his agent; and it is immaterial that a further destination for the goods may have been indicated by the buyer.

(c) If the carrier or other bailee wrongfully refuses to deliver the goods to the buyer or his agent in that behalf.

(3) If goods are delivered to a ship chartered by the buyer, it is a question depending on the circumstances of the particular case, whether they are in the possession of the master as a carrier or as agent of the buyer.

(4) If part delivery of the goods has been made to the buyer, or his agent in that behalf, the remainder of the goods may be stopped in transitu, unless such part delivery has been made under such circumstances as to show an agreement with the buyer to give up possession of the whole of the goods.

This right of stoppage exists only when the purchaser apparently becomes insolvent after the sale or was insolvent when the sale was made, although that fact was not discovered by the vendor until later. Actual or technical insolvency of the purchaser is not an absolute requisite. It will suffice if the purchaser by his manner of conducting his business and meeting his obligations furnishes the ordinary apparent evidences of insolvency. Thus, the right exists where the purchaser has not been able to meet his bills at maturity, or where his notes have gone to protest because of his inability to pay them in the regular course of business. If, however, the seller stops the goods when there are no evidences of the buyer's insolvency, he will be compelled to deliver the goods and, in addition, he will be answerable for any damages caused to the buyer by the delay.

When the seller desires to exercise the right of stoppage in transitu he should notify the transportation company or its agents to hold the goods. No special form of notice is necessary. The usual method is to notify the carrier of the seller's claim and require the carrier to hold the goods, forbidding their delivery to the purchaser. Section 59 of the Uniform Sales Act provides:

Ways of exercising the right to stop.—(1) The unpaid seller may exercise his right of stoppage in transitu either by obtaining actual possession of the goods or by giving notice of his claim to the carrier or other bailee in whose possession the goods are. Such notice may be given either to the person in actual possession of the goods or to his principal. In the latter

case the notice, to be effectual, must be given at such time and under such circumstances that the principal, by the exercise of reasonable diligence, may prevent a delivery to the buyer.

(2) When notice of stoppage in transitu is given by the seller to the carrier, or other bailee in possession of the goods, he must redeliver the goods to, or according to the directions of, the seller. The expenses of such delivery must be borne by the seller. If, however, a negotiable document of title representing the goods has been issued by the carrier or other bailee, he shall not be obliged to deliver or justified in delivering the goods to the seller unless such document is first surrendered for cancellation.

Section 62 provides :

Effect of sale of goods subject to lien or stoppage in transitu.—Subject to the provisions of this act, the unpaid seller's right of lien or stoppage in transitu is not affected by any sale, or other disposition of the goods which the buyer may have made, unless the seller has assented thereto.

If, however, a negotiable document of title has been issued for goods, no seller's lien or right of stoppage in transitu shall defeat the right of any purchaser for value in good faith to whom such document has been negotiated, whether such negotiation be prior or subsequent to the notification to the carrier, or other bailee who issued such document, of the seller's claim to a lien or right of stoppage in transitu.

It is apparent from the second paragraph of the foregoing section that the right of stoppage will be defeated if the bill of lading is in negotiable form and

has been transferred by the purchaser to a bona-fide purchaser for value. This is based on the theory that it is better to limit the right of stoppage in transitu of a seller who has intrusted the buyer with a perfect apparent title, than to deprive the innocent purchaser of the goods. However, a resale of the goods by the vendee without a transfer of a negotiable document of title will in no way affect the vendor's right of stoppage.

RESULT OF STOPPAGE IN TRANSITU

The fact that the seller has exercised the right of stoppage in transitu does not necessarily result in a rescission of the original contract of sale, unless the two parties have so decided either by word or action. For the purchaser's non-performance of the contract, then, the seller has a right to sue for damages representing the loss sustained through the buyer's non-performance or by a fall in the market price of the goods. And, in view of the fact that stoppage in transitu does not rescind the contract of sale, the purchaser may obtain the goods on paying the price; or, in case the purchaser is willing and able to carry out his part of the contract, he can sue the seller for damages for failure of the seller to deliver the goods according to the contract terms.

RESALE BY THE SELLER

Under certain circumstances the seller may resell the goods stopped in transit. Section 60 of the Uniform

Sales Act, which prescribes the time and manner of resale, says:

When and how resale may be made.—(1) Where the goods are of a perishable nature, or where the seller expressly reserves the right of resale in case the buyer should make default, or where the buyer has been in default in the payment of the price an unreasonable time, an unpaid seller having a right of lien or having stopped the goods in transitu may resell the goods. He shall not thereafter be liable to the original buyer upon the contract to sell or the sale or for any profit made by such resale, but may recover from the buyer damages for any loss occasioned by the breach of the contract or the sale.

(2) Where a resale is made, as authorized in this section, the buyer acquires a good title as against the original buyer.

(3) It is not essential to the validity of a resale that notice of an intention to resell the goods be given by the seller to the original buyer. But where the right to resell is not based on the perishable nature of the goods or upon an express provision of the contract or the sale, the giving or failure to give such notice shall be relevant in any issue involving the question whether the buyer had been in default an unreasonable time before the resale was made.

(4) It is not essential to the validity of a resale that notice of the time and place of such resale should be given by the seller to the original buyer.

(5) The seller is bound to exercise reasonable care and judgment in making a resale, and subject to this requirement may make a resale either by public or private sale.

person, no matter what value the third person paid, nor how innocent he may be. Thus, a person may obtain possession of goods by fraudulently impersonating another or fraudulently pretending to be the agent of another, to whom the owner of the goods imagines he is selling on credit. In this case the owner of the goods never intends to pass title, nor does he consent to sell to the person to whom the goods were delivered. Hence the person who obtains the goods acquired no title, and any one who purchases from him acquires no better title. In this case, then, the original owner of the goods may obtain them from any one who has possession of them.

WAIVER OF RIGHT TO RECOVER

A seller may, by his act or word, waive the right to recover the goods. Where, for example, the seller has full knowledge of the fraud committed by the purchaser, and then accepts payment or a note or security, the right of recovering the goods is lost. A mere demand for payment, however, does not amount to a waiver of the right to recover. But, if the seller brings a suit for the price of the goods, knowing all of the facts, he is estopped from reclaiming the goods, for his action amounts to an affirmation of the contract of sale. However, if any of these actions are taken by the seller before he knows anything about the fraud he would not be estopped from recovering the goods.

The bankruptcy of the purchaser does not affect the seller's remedy of recovery of the goods themselves.

ATTACHMENT

Another remedy available for the protection of creditors is that of attachment. The writ of attachment enables a creditor to have property of the debtor seized and held for the payment of a debt on which suit has been or is about to be brought by a creditor. This right of attachment is a purely statutory one and is available only on those grounds specifically enumerated by the statutes of the various states. The statutes differ widely, but in general they provide that a creditor may attach the property of a debtor on one of the following grounds :

1. That the debtor is a non-resident of the state where the writ of attachment is sought against the debtor's property located within the state.

2. That the debtor has departed from the state with intent to defraud creditors or to avoid service of legal process.

3. That the debtor with like intent keeps himself concealed within the state.

4. That the debtor has removed property or is about to dispose of property for the purpose of defrauding his creditors.

5. That the debtor has secured property from the creditor by fraudulent representations, such as the making of a false statement in writing regarding his financial position.

These grounds for obtaining an attachment against the property of the debtor are not common to all states, while in some states there are additional grounds for using this remedy. A careful study of the statutes of

the state, wherein the remedy is sought, is necessary in each case.

ADVANTAGES OF ATTACHMENT

In practically all states, the statutes authorizing attachments require, as a condition precedent to the issuance of the writ of attachment, that a bond shall be given by the creditor to cover the costs of the proceedings and to protect the debtor from any injury which would result from a wrongful attachment.

The important advantage of issuing an attachment is apparent to those creditors who have had the experience of suing a debtor, who apparently had assets at the time the suit was begun, but whose assets have disappeared and are untraceable after judgment is obtained. Where attachment is available, the creditor may have the property of the debtor seized before suit is brought, and held after judgment is obtained, when the attached property may be sold and the judgment satisfied.

SUPPLEMENTARY PROCEEDINGS

It is true, however, that where the debtor transfers his property after suit is brought, even where attachment is not resorted to, the creditor may, after obtaining judgment, examine the debtor in supplementary proceedings to discover what disposition the debtor has made of the property. Of course, if during the examination in supplementary proceedings, the creditor discovers the debtor has fraudulently transferred the property, for example, to his wife without receiving any valuable consideration therefor, the judgment

creditor may have the transfer set aside. The property would then become available for the satisfaction of the creditor's claim.

GARNISHMENT

Where property has been transferred for the purpose of defrauding creditors, the creditor may, in many jurisdictions, hold the transferee liable as trustee to account for the property or its proceeds. This right is known as the right of garnishment. It applies not only to the case described, but also to any case where a third party has in his hands any funds or property belonging to the debtor. Like the right of attachment, garnishment is essentially a statutory remedy, and its scope and application is limited by the statutes of each state.

BULK SALES LAW

Debtors have frequently, in an attempt to defraud their creditors, resorted to the scheme of selling their entire stock in bulk at a price considerably below the actual value of the stock. The sale might be made either to a confederate wrongdoer or to one who permitted his morals to become blunted by the monetary gain possible from the low-priced purchase. The debtor, having disposed of the stock, would then find it an easy matter to dissipate or conceal the proceeds of the sale and successfully make a fraudulent failure; or after completing the sale, he might be inclined to remove to other parts without notifying his creditors.

To place difficulties in the way of such debtors, if

not to eliminate entirely their contemptible practices, the various state legislatures, usually at the instance of the National and local associations of credit men, have passed so-called bulk sales laws. The object of these laws is to prevent a repetition of the injurious and dishonorable practises described above, usually by compelling the purchaser of the bulk stock to obtain a list of the seller's creditors and to notify them of the sale at least five days before the completion of the sale. While these laws differ in a number of the states, the penalty prescribed for failure of the bulk goods purchaser to notify the creditors is in most instances to make the sale either absolutely void or presumptively fraudulent on creditors.

In general, the states having laws regulating the sale of goods in bulk may be divided into five groups. The first of these, consisting of four states, requires notice of the proposed sale to be publicly recorded from five to ten days before the sale is completed. Creditors who are subscribers to the large mercantile agencies would receive notice from the agency of such recording and thus be stirred to further action.

The second group, of fourteen states, require that the purchaser demand and receive of the seller a list of the names and addresses of his creditors and amount due each; the purchaser is also required to notify each creditor of the terms and conditions of the sale, either personally or by registered mail, from five to ten days before the sale is completed.

The third group, of eighteen states, have the same requirements as the second group and in addition require an inventory to be taken and notice to be given

in person or by registered mail, as in the second group.

The fourth group of states, four in number, require the purchaser to demand a sworn statement containing a list of the debtors and creditors and provide that all sales in bulk shall be void unless the purchaser shall pay or see to it that the purchase money of such property is applied to the payment of all bona fide debts of the vendor, share and share alike.

Louisiana statutes make it a misdemeanor to purchase goods on credit and to sell or otherwise dispose of them out of the usual course of business, with intent to defraud, and also for a purchaser to purchase a stock of goods in bulk without first obtaining a sworn statement from the vendor that they are paid for.

THE USE OF THE BULK SALES LAW

As a general principle in regard to the Bulk Sales Law, it may be said that its chief practical advantage is that it puts the burden of proof upon the defendant in cases where a creditor seeks to set aside sales of goods as fraudulent. The creditor is obliged merely to show that the sale took place without conforming to the requirements of the Bulk Goods Law. That automatically creates the presumption pursuant to the statute that the sale was fraudulent and shifts the burden of proof to the defendant, who is then obliged to prove that the sale was bona fide.

In some states, where the sale is by statute made absolutely void for non-conformity, it may be held that the presumption thus raised is not rebuttable by the purchaser in bulk, in which case the sale is set aside

by decree of court, and the property then becomes subject to levy under execution against the seller.

Most, if not all, States have a law permitting the setting aside of sales where the sale was without consideration or for the purpose of preventing creditors of the seller from levying. This law is one very difficult to use successfully on account of the frequent impossibility of producing evidence to show that the sale was without consideration or was otherwise fraudulent, as all of such evidence is in the possession of the parties to the sale, who are obviously secretive. The Bulk Law enables creditors to make use of such statutes by throwing the burden on the purchaser of proving that the sale under which he took the goods was free from taint.

Practically, the use of the Bulk Law varies in various states according to the character of the statutes in those states pertaining to attachments, garnishee process and other remedies provided. A typical case would be for the commencement of an action by the creditor against the debtor and the purchaser of goods in bulk, in which case an attachment or garnishee process would be issued, setting up fraud in that the terms of the Bulk Law were not complied with. Armed with this process, the sheriff or other appropriate officer seizes the goods thus sold in bulk from the possession of the purchaser and holds them to await the outcome of the trial of the action. In that action the creditor merely shows that the debtor sold his stock without complying with the Act. This creates a *prima facie* case in support of the creditor's contention that the sale was fraudulent. If the debtor

or the purchaser of the goods in bulk is unable to show that he gave full value for the property and had no reason to suppose that the property was being disposed of for the purpose of defrauding creditors, the plaintiff would win his action, and the sheriff would turn over the goods or the proceeds of their sale at auction to him under the execution issued upon the judgment. If, on the other hand, the purchaser of the goods in bulk succeeded in showing that the purchase was made by him for approximately fair value, without fraud of any kind, the attachment would be vacated and the creditor would lose his case, except in those states where sales in bulk are declared absolutely void for non-conformity with the statute.¹

In the latter case, assuming that the proper notice has been given by the vendee under the Bulk Sales Statute and the money paid over but possession of the merchandise not taken at the end of the fifth day, the creditors may attach the merchandise, stock or fixtures or use any other legal process competent to get the assets for the payment of their claims. If possession of the stock has been taken in less than five days, and the notice was duly given by the vendee under the Bulk Sales Law, and the money was held until the end of the five days, then the creditor may subject the money in the hands of the vendee for the payment of his claim.²

On the other hand, if the act has not been complied with by the vendee or the vendor in transferring goods,

¹ From *A Brief—Hints on Using the Bulk Sales Law*, National Association of Credit Men.

² From National Association of Credit Men's circular.

wares, merchandise and fixtures, the creditor's remedy is by way of application to the court asking for the appointment of a receiver to take charge of and hold the property which has been transferred, or setting forth the facts and praying that the purchaser be declared a trustee for the benefit of the creditors of the seller, that the debts be determined and an appraisal of the property made, the property sold and the proceeds accounted for and distributed to the creditors of the original seller. The petition to the court must be made within ninety days subsequent to the transfer of the goods, wares, merchandise or fixtures.

Upon the filing of the application, after showing that the act has been violated, the court without further proof should declare the purchaser a trustee or appoint a receiver to take charge of all of the property transferred, and administer it for the benefit of the creditors of the vendor.

CHAPTER XVI

EXTENSIONS, COMPOSITIONS AND ADJUSTMENTS

Sometimes a debtor finds that he has a large equity in his business, that is, an actual surplus of assets over liabilities, but that he cannot continue to meet his obligations as they mature. This condition is usually due to an insufficiency of working capital, caused by overstocking, a policy of too liberal credit granting, carelessness in making prompt collections of outstanding accounts, or even the impossibility of making collections on account of a general or local business depression.

MOTIVES PROMPTING AN EXTENSION

When a debtor is thus situated his wisest course is to consult with his largest creditors and seek an extension of time in which to meet his obligations. From purely selfish motives every credit man should give serious consideration to such a request, this for the reason that the action of certain credit men in refusing to give careful heed to a debtor's petition, and in vigorously insisting upon immediate and full payment, has resulted very frequently in the failure and bankruptcy of the debtor with the ensuing large and probably unnecessary losses to both debtor and creditors,

Under the same circumstances forbearance and watchfulness on the part of the creditors, even to the extent of actively supervising the business of the debtor, might have brought about an entirely different outcome—probably the eventual payment of all debts in full and the continuation of profitable business relations with the debtor.

THE HUMANITARIAN SIDE

Then, too, humanitarian motives should prompt the credit man to act with the utmost care, even hesitancy, before resorting to any drastic action which would bring about the bankruptcy of an honest debtor. Let every credit man realize that business losses are practically inevitable and that the most scrupulous and conscientious of debtors may face reversals due to causes beyond their control. These debtors, at least, are entitled to the moral support and active assistance of their creditors, who, over a series of years, have made profits out of their business relations with the now unfortunate debtor. The credit man must make no mistake in dealing with such an embarrassed debtor. A false step by the creditor may precipitate the debtor's bankruptcy, resulting in irreparable injury not only to the debtor himself, but also to the debtor's family and dependents. When, therefore, a debtor asks for an extension or seeks a composition, it is incumbent on every creditor to make searching inquiry before refusing the debtor's request.

WHEN TO GRANT AN EXTENSION

Among the important questions for the credit man to answer when a debtor seeks an extension are the following:

First. Is the debtor honest? Here character is all important. If the creditor is dishonest he is not entitled to consideration by his creditors. If he lacks that necessary quality of character his integrity cannot be relied upon to protect the interests of his creditors and an extension of time would simply give the dishonest debtor an additional opportunity to perpetrate a fraud upon his unsuspecting creditors.

Second. Has the debtor sufficient strength to continue in business and extricate himself from his present difficulties? In other words, will the assistance given him enable him to continue successfully? Here the *capacity* of the debtor is the determining factor.

When a debtor asks for an extension, he exposes his condition and impairs his credit in all markets. This effectually shuts off the debtor's credit in new markets and imposes upon those creditors granting the extension the obligation of continuing to sell the debtor. This is in most cases practically mandatory, for the debtor must have new and fresh merchandise to replenish his stock to meet the demands of his own customers. Inasmuch as the debtor finds it impossible to obtain any new credits, he must obtain the merchandise from his old creditors, and their failure to supply the merchandise diminishes their chances of eventually being paid for the original indebtedness.

Whether or not the impairment of the debtor's credit

will be so serious as to make it impossible for him to continue and successfully extricate himself depends largely on his condition at the time the extension is sought. If the debtor has been in good standing and can demonstrate to his creditors that his condition is only temporary, they will in all probability continue to check ¹ him, and he will eventually be able to work his way out of his difficulties.

REASONS FOR EMBARRASSMENT

A third matter for the creditor to consider is the reasons for the debtor's embarrassment and the prospects of improvement or aggravation of the debtor's condition.

The debtor may be tied up with a large stock of merchandise, most of which is saleable. This stock when gradually liquidated may provide sufficient cash to pay all old indebtedness. Under these circumstances the debtor will not find it necessary to make many additional purchases before discharging his debts, and he can obtain such additional stock, as he needs, from his old creditors or for cash in the open market.

On the other hand, the debtor may have outstanding accounts receivable which are good and collectible but slow-paying. The slow-paying condition of the accounts may be the result of outside conditions or of the collection methods of the house. In the former case time itself will usually remedy the conditions, while in

¹ A technical expression which means the creditor approves the debtor's request for credit.

the latter case the collection methods may easily be rectified.

THE SITUATION IN THE SOUTH IN 1914

Illustrative of outside conditions affecting debtors is the situation which existed in the South in the fall of 1914, immediately following the outbreak of the Great European War. At that time the price of cotton was so low, and so impoverished was the South generally, that many Southern consumers found themselves unable to pay the retailers from whom they bought goods on credit. The retailers, in turn, had large outstanding accounts receivable which were quite certain to be collected with a satisfactory change in the cotton market, but they did not have any ready funds to pay the Southern jobbers. Some of these jobbers consequently could not pay the northern manufacturers, and sought extensions for from six to twelve months, offering their notes to the manufacturers. The manufacturers, almost to a man, quickly saw the situation and recognized the cause of the Southern jobbers' difficulties. Extensions were willingly granted and the jobbers' credit standings remained unimpaired. Eventually, with a favorable change in the price of cotton, the jobbers, collecting from the retailers, paid their debts and continued their business relations with the manufacturers.

THE SITUATION OF A METROPOLITAN STORE

A very interesting illustration of the embarrassment of a debtor as the result of improper collection methods

is the case of a large metropolitan department store. This store is one of the foremost concerns in its city. It caters largely to a very wealthy class of customers, and the majority of its sales are made on credit. For fear of offending its wealthy, and presumably aristocratic, customers, the store never sent statements, but relied entirely on the purely voluntary act of its customers to pay their bills. This exceedingly lax method of collecting accounts necessarily encouraged the customers to procrastinate making payments. This compelled the store to borrow frequently and in large amounts at a local bank. With the proceeds of the bank loans the store paid its merchandise bills very promptly and maintained a high credit rating among the trade.

For some unexplained reason, possibly because of the careless collection methods of the store, the bank refused to make any further loans to the store. Of course the store found it impossible to borrow at any other local bank at that time, for the mere fact that the bank which had been lending the store money over a great number of years had suddenly shut down on the store, would prove a sufficient deterrent to other banks.

In a reckless attempt to maintain its credit standing the store committed the serious tactical error of endeavoring to pay its few large creditors promptly and delaying the payment of numerous small creditors. This is a grave mistake for any debtor to make, for the reason that in case of financial difficulty he will find it almost impossible to come to any satisfactory understanding with numerous small creditors whose first in-

spiration, when a debtor becomes embarrassed, is to turn the account over to a lawyer. And unfortunately these small creditors seem to be unusually successful in selecting either lawyers who are thoroughly unscrupulous and whose sole ambition is to add to the intricacies of the situation (and to their fees) and tear down business structures, or lawyers who are entirely devoid of sound business judgment. Fortunately this class of lawyers is probably in the minority.

On the other hand where the number of creditors is small, the debtor has no such unwieldy mass to deal with. Then, too, large creditors usually have credit men who prefer to take the situation in hand themselves, without calling in any outside attorneys whose presence might complicate matters. For these reasons, a debtor who is compelled to seek the co-operation of his creditors will do well first to dispose of the numerous small creditors, and then present his case to the small number of large creditors.

Returning to the situation of the metropolitan store, when the small creditors found they were not being paid promptly, they soon began to circulate rumors that the store was getting into financial difficulties, and the credit reputation of the store began to weaken. These rumors in a short time came to the attention of the large creditors. The large creditors called the managers of the store to account for the rumors. The store managers willingly exposed the store's condition to the large creditors, permitted the creditors to investigate the affairs of the store, and asked the creditors' advice. The creditors found the condition of the store quite satisfactory, except for the method of

collecting accounts. The large creditors advised the store to pay all the small creditors immediately. This effectively stopped the rumors that had been circulating and tended to save the credit of the store. The large creditors, after the store had agreed to adopt better collection practises, consented to grant an extension of time to the store. Thus, through the judicious action of the large creditors, this store was probably saved from failure, and all creditors were paid in full.

LEGAL ASPECTS OF EXTENSIONS

The question may arise, in the minds of either the creditors or debtors, whether an agreement for an extension of time is binding on the creditors. Every contract or agreement to be binding must be supported by some consideration. Obviously an agreement by one creditor to give a debtor an extension of time, without any consideration, is not binding on the creditor. Where, however, several creditors agree among themselves and with the debtor, that in consideration of each creditor's forbearance each of the other creditors will agree to an extension, there is sufficient consideration to support the promise of each creditor; and no one creditor, at least without the consent of all others, would have the right to demand payment before the extended time had elapsed.

In any event, if the extension is accomplished by the debtor giving the creditor a note, the creditor would have to wait until the due date of the note to bring any action against the debtor. The giving and acceptance of the note in place of the old account is prac-

tically the substitution of a new contract for an old one and, therefore, binding on both parties. Again, where the debtor gives security or obtains a guarantor in consideration for extension of time granted, the agreement is supported by sufficient consideration and, therefore, binding.

COMPOSITION SETTLEMENTS

Under certain circumstances it would be unwise for creditors to grant an extension. This is obviously true, for example, where a debtor's statement discloses an actual deficit, or where the surplus of assets is negligible, or where the assets, even though considerably more than the liabilities, are made up largely of fixed assets not readily convertible into cash. Under such conditions, simply to grant an extension would hardly be an adequate remedy. The extension will not enable the debtor to present any better statement nor to increase his working capital. As a result his credit will be so seriously injured and his buying so seriously restricted that he will find himself going from bad to worse. More heroic measures are necessary if the debtor is to be saved from bankruptcy, and enabled to continue business.

One adequate remedy is the common law or composition settlement. This is an agreement between the debtor and several of his creditors (not necessarily all, but a number, two or more) whereby each of the creditors in consideration of each other's promise, agrees to release the debtor from the entire debt upon receiving partial payment from the debtor. The mere agree-

ment of one creditor alone, and not in consideration of other creditors' promises, would not be binding on that creditor. It is essential that two or more creditors enter into the agreement.

The composition settlement is usually brought about on the initiative of the debtor, who submits a proposition to his creditors offering to pay a certain percentage of their claims. The proposal may be made directly by the debtor or through the instrumentality of his attorney, either to the creditors individually or at a meeting of creditors called for the purpose. This kind of settlement is always very difficult to arrange when the creditors are very numerous, for, among many, there are quite likely to be one or more disgruntled creditors who insist upon full payment. Where, however, the creditors are few in number, and friendly toward the debtor, not many obstacles will be met in bringing about an equitable settlement.

WHEN TO AGREE TO A COMPOSITION

This form of settlement is highly to be commended, and the creditors should agree to such a settlement, under proper conditions, for two reasons.

First. This form of settlement is due to the honest debtor. The creditor is in a way a partner in the debtor's business, and losses must be expected in business. An honest debtor's offer should be encouraged and accepted, so that the debtor may regain his business and save himself and family from disaster.

Second. It is to the interest of the creditor to have a settlement made in this form. To illustrate, let us

assume that a merchant has a business which shows a relation of 75% assets to liabilities. The business may be worth 75% of the liabilities as a going concern. But in forced liquidation the assets would realize much less than their book value. If the business went through bankruptcy, the creditors would consider themselves fortunate to receive twenty per cent. How much more fortunate is the creditor who accepts a settlement of forty per cent and leaves the debtor thirty-five per cent to continue and rehabilitate his business! Moreover, the loss sustained by the creditor may be recouped in future sales to the debtor. This would be quite unlikely, if not impossible, were the debtor forced through bankruptcy. Then, too, bankruptcy proceedings use up the time of all parties and cause many creditors considerable trouble and worry, all of which is dispensed with through a common law settlement.

To summarize, an honest debtor is rightfully entitled to a composition settlement. However, before accepting an offer of settlement the creditors should obtain full and complete information regarding the debtor's affairs, and assure themselves beyond a reasonable doubt that there is an entire absence of fraud. If the credit man discovers any trace of fraud he should absolutely refuse to grant an extension or agree to an extension. Let him relentlessly prosecute the fraudulent debtor to the full extent of the law. This, to the individual creditor, may be very expensive in the immediate case, but eventually the money spent in prosecuting this fraudulent debtor will pay large dividends, for the reputation gained from prosecuting the

fraudulent debtor will have a salutary effect upon all other frauds. They will take care to see that this creditor is omitted from their list of creditors.

LEGAL ASPECTS OF A COMPOSITION

We have already pointed out that the consideration for a composition agreement which makes it binding on the parties is the promise of each creditor in consideration for the promise of all the other creditors signing the composition agreement. It is to be pointed out here, however, that the composition need be in no particular form. It may be a formal instrument under seal or, unless otherwise provided by the statutes of the state, it may be in the form of a simple, written instrument or even an oral agreement. Nor is it necessary in order to make the agreement valid that all or even a greater part of the creditors should join, unless this is required by the agreement. Of course, any creditor may make this a condition precedent to his entering into the agreement.

All creditors must share equally in the distribution of the assets and in every other respect and any advantage given to one or more of the creditors without the consent of the others will avoid the composition agreement. However, the creditors may, among themselves, agree to allow one creditor to receive more than the others.

In carrying out the terms of the composition agreement, it is absolutely essential that they be performed punctually and strictly in accordance with the terms of the agreement. The composition money, or any in-

stallment, if the composition happens to be payable in installments, must be paid punctually at the time specified by the agreement. Moreover, any note or bill called for by the agreement must be delivered at the time and in the manner specified, and must be paid promptly when due. Should any of these requirements not be fulfilled, the creditors, or any one of them, would have the right to consider the agreement broken and to immediately begin an action for the recovery of the original indebtedness.

ADJUSTMENT BUREAUS

To secure the effective co-operation of creditors in dealing with embarrassed debtors, credit men's associations and trade organizations have established adjustment bureaus. The purposes of these bureaus may be summarized as follows:

1. To investigate, upon request, the affairs of a debtor reported to be insolvent and adjust the estate, when possible without court proceedings.
2. To secure capable and efficient receivers, appraisers or trustees when court proceedings are found to be necessary.
3. To secure quick adjustment of all honest failures at the minimum cost and with the maximum dividend to creditors.
4. To facilitate and economically to secure extensions or liquidations when, upon investigation, it is found to be to the best interests of all.
5. To influence concerted action by the creditors for the benefit of all.

6. To assist creditors to acquire for their own use the estate of failing or insolvent debtors, when mutually agreed upon.

7. To prosecute or assist in the prosecution of the guilty party or parties where investigation discloses fraud or the intent to defraud.¹

ADVANTAGES OF THE ADJUSTMENT BUREAU

To summarize, the adjustment bureau seeks to represent and act as agent for all creditors of an embarrassed or insolvent account and attempts to secure for each creditor the most satisfactory form of settlement. Practically, the adjustment bureau takes the place of a committee of creditors, but is usually better equipped than the committee, by reason of its better facilities and wider experience in treating with insolvent debtors. Moreover, the adjustment bureau has developed a valuable organization of adjusters, appraisers, and attorneys that can be called into service the moment the occasion requires.

When an extension or common law composition is desirable the adjustment bureau can play a valuable part. As most credit men have experienced, a settlement of this kind presented to the individual creditors by the debtor will usually meet with serious opposition from a few creditors; furthermore, a number of indifferent creditors may retard the consummation of the settlement by neglecting to give their assent. Particularly is this true when there are numerous cred-

¹ Bulletin of National Association of Credit Men, July, 1906.

itors who are located at a distance from the debtor. When, however, after a careful examination of the debtor's affairs, the extension or composition is recommended by the adjustment bureau, most creditors, if not all, will consent to the arrangement suggested by the bureau. In the first place, the creditors feel a strong moral obligation to do this, and secondly, the creditors realize that the bureau is obtaining for them probably the most advantageous settlement possible.

WINDING UP AN ESTATE

In place of an extension or composition settlement it may be thought more desirable to wind up the affairs of the debtor, sell out his property, and distribute the proceeds pro rata among all the creditors. This result can, of course, be accomplished through bankruptcy proceedings. But the objection to these proceedings is threefold: first, bankruptcy leaves a stain on the business name of the debtor; second, the fees to attorneys and officials eat up a considerable part of the estate, and third, the trustee, whose duty it is to dispose of the assets of the debtor, often lacks either the ability or the time to sell the assets in the most advantageous manner.

The plan of the adjustment bureau, while retaining the sound and beneficial principle of pro rata distribution of the debtor's assets, dispenses with the serious objections to bankruptcy administration of the insolvent's estate. Their plan embraces the surrender by a debtor of his property to a trustee, a representative of the adjustment bureau, for the benefit of all cred-

itors. It is a voluntary assignment apart from any legal proceeding. The debtor, by plain bill of sale or deed of assignment in simple form, conveys his property to a trustee, authorizing the trustee as attorney in fact to take possession of the property and convert the same into money, and after the payment of the necessary expenses, to distribute the proceeds pro rata among the creditors, who in consideration thereof agree to release the debtor from further liability.

This proceeding is subject to legal attack, and must and does rest upon the co-operation of creditors. To avoid any possible legal entanglements, such as bankruptcy, the consent of all creditors should be obtained to the assignment and release. For this consent the results obtained in the form of larger dividends are usually a sufficient inducement. Where, however, certain creditors refuse to enter into the equitable spirit of the agreement, and insist on being paid in full, there is nothing for the adjustment bureau to do but to threaten to file a petition in bankruptcy. This will ordinarily bring the recalcitrant creditors to terms, for even they realize that the dividends would be considerably reduced if the debtor's estate were to pass through bankruptcy. If the threat itself is unavailing, the bureau will see the petition is filed either by the creditors or by the debtor himself.

ACTIVITY IN BANKRUPTCY CASES

When bankruptcy cannot be avoided, either on account of conflicting interests among creditors, or their attorneys, or because the debtor himself has filed a

voluntary petition, the adjustment bureau can be of expert assistance in representing creditors at creditors' meetings, and especially in the election of a trustee who can best serve the interests of the creditors. This trustee may well be and often is a representative of the bureau, in which case the bureau's experts aid in obtaining the highest prices for the debtor's assets and in keeping down the cost of administration to a minimum.

ADJUSTMENT PROCEDURE

Upon the request of one or more creditors the adjustment bureau, after consultation with other creditors, makes a thorough investigation into the affairs of the debtor. As a result of the examination, the bureau makes its recommendations to the creditors. If a composition settlement is thought desirable, the bureau makes every effort to effect a satisfactory arrangement.

If an extension is to be arranged, one of several methods may be followed. A trust agreement may be entered into between the debtor and the bureau on behalf of the creditors. The agreement may provide for a continuation of the business either by the debtor himself or by a representative of the bureau. In the latter case the debtor might be retained as an employee, until the debts were all paid, the business then to be returned to the debtor. The success of this latter method depends entirely on the ability of the bureau's manager and representatives. Efficient merchandising men could reduce store expenses, stop leaks, collect outstandings, increase sales, and turn back to the debtor a rehabilitated business.

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When an extension agreement is decided upon, the bureau usually asks the creditors to assign their claims to it. This accomplished, the debtor has only one creditor instead of a great number, and neither the creditors nor the debtor are in constant apprehension of one or two creditors insisting upon payment and taking drastic action at any time. As the money is received by the bureau from the debtor or from the sale of the debtor's stock, dividends are distributed *pro rata* among all the creditors.

If it is considered better to wind up the business of the debtor, an assignment is made by him to the bureau as trustee.¹

The bureau takes charge of the store of the debtor and makes an inventory of the stock and equipment. The store is arranged as attractively as possible for the reception of prospective purchasers of the stock. Depending on the circumstances of the case the bureau may then do one of four things.

1. It may sell the goods and fixtures at public auction.

2. It may sell the stock in job lots, to buyers of bankruptcy stocks and to storekeepers at private sale. This method has usually produced better results than public auction.

3. It may continue the business, gradually disposing of the stock at retail. If this is done new merchandise must be purchased from time to time to replenish the stock, and the creditors must wait until all or most of the goods are sold before any dividends are received.

¹ See page 323, *ante*.

One advantage of this method is that higher prices may be realized on the stock.

Whichever method is followed, the creditors are usually compelled to wait at least four months after the assignment before they receive any dividends. This is for the reason that the adjustment bureau does not want to assume any risk should certain previously unheard of creditors appear and demand payment, after the debtor's estate has been wound up but before the four months' period has elapsed. These creditors could file a petition in bankruptcy and set aside the assignment, as a preference, and compel the adjustment bureau to account for the money received from the sale of the bankrupt's property. The bureau would then be in a very embarrassing position, if it had already distributed the money. For this reason the bureau makes no payments to creditors until at least four months after the assignment.

ADJUSTMENT BUREAU RESULTS

From an economic point of view the figures presented by the various adjustment bureaus justify beyond any doubt the existence of these bureaus. The average dividends paid to creditors in winding up estates have been considerably higher than in bankruptcy cases carried through the courts. In many instances, dividends distributed by the bureau have amounted to 100%, the full amount of the creditors' claims. Even in bankruptcy, the presence of the adjustment bureau has usually resulted in larger dividends for creditors.

Figures from the Report of the Spokane Mer-

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chants' Association for the year 1911 are typical and instructive.

Cash received outside of bankruptcy.....	\$440,292.95
Cash disbursed to creditors.....	424,558.89
	<hr/>
	\$15,734.06
Expense for collection and distribution....	15,329.61
	<hr/>
Cases paid in full, 1911.....	18
Average paid to creditors in 84 cases closed by Association	54.8%
The above record may be compared with Spokane <i>bankruptcy</i> cases:	
Total Asset cases in bankruptcy closed in 1911	17
Average paid	9½%
Average paid in bankruptcy cases con- trolled by Association.....	24.4%
Largest paid in any case.....	39.4%

FUTURE OF THE ADJUSTMENT BUREAU

With bureaus exhibiting records like the above, there is every reason to believe that the future holds out the brightest prospects for their continued successful development. Already there are approximately fifty bureaus distributed over twenty-five states affiliated with local Credit Men's Associations, and we may reasonably expect to see an increment in their number and an improvement in the quality of many of them.

CHAPTER XVII

BANKRUPTCY, INSOLVENCY AND RECEIVERSHIPS

ORIGIN OF BANKRUPTCY LEGISLATION

The present day bankruptcy laws probably find their origin in the Roman *cessio bonorum*, under which an insolvent debtor might, by surrendering all of his property to his creditors, obtain immunity from imprisonment and severe corporal punishment, which would otherwise be inflicted. The first English bankruptcy statute, that of Henry VIII, was passed in 1542 and forms the basis for much of our present bankruptcy legislation. That statute, however, contained no provision for voluntary bankruptcy, nor did it provide for the discharge of the debtor's debts remaining unpaid. The underlying purpose of the law was not then, nor is it to-day, the release of the debtor from his liabilities. Not until 1705 did any bankruptcy law permit the discharge of a bankrupt from the debts his estate could not satisfy.

THEORY OF BANKRUPTCY LAWS

The Bankruptcy Law's underlying theory evidently is that so long as a merchant is solvent he is doing

business on his own money and may do with it as he wills, but the moment he becomes insolvent he ceases to be doing business on his own money—he has spent his own—and is beginning to do business upon his creditor's money. From this premise it necessarily follows, in theory, then, that the remaining assets in the debtor's hands are the property of his creditors, for whose benefit merely he holds them. The law does not say so in these very words, but in the philosophy of the law and in economics some such theory must certainly lie at the basis of the peculiar protection thrown about the insolvent fund by the Bankruptcy Law. Therefore it is that the insolvent debtor is prohibited by the Bankruptcy Law from making transfers to one of his creditors of more than that creditor's proportionate share; that is to say, it prohibits "preferences," by permitting their recovery from the creditor preferred—if bankruptcy follows within four months. Thus it is, also, that the law renders nugatory the seizure under legal process by one creditor of any part of the insolvent estate within the same limited period before bankruptcy. These are the only rights and remedies conferred by the Bankruptcy Law that are peculiar, and they are conferred precisely in order that insolvent estates may be administered for the creditors as a whole and not be given over to one or two, who may be preferred by the debtor or who may resort to legal process before others.¹

Moreover, the present Bankruptcy Law undertakes

¹ Remington, *Bankruptcy Law and Peaceable Settlements of Business Failures*, a booklet published by the National Association of Credit Men.

to discharge honest debtors from those obligations they are unable to pay. In doing this, the law takes cognizance of the economic importance of relieving a debtor of onerous burdens, so that he may restore his commercial vitality and continue as a useful member of the business community.

In summary, then, it may be said that as bankruptcy jurisprudence now stands in the United States, it is a system of laws providing the machinery for taking possession of the assets of an insolvent, either upon his own initiative, or, in case he has done certain acts, called acts of bankruptcy, considered to demonstrate his unworthiness or incapacity properly to continue his business, upon the initiative of his creditors; for recovering his assets including such as have been transferred fraudulently to third parties or unfairly to particular preferred creditors or have been seized by creditors while the debtor was insolvent; for selling the assets and distributing the proceeds equitably among his creditors; and, finally, for granting to him, in case he has surrendered all his assets and disclosed to his creditors in bankruptcy the truth about his business dealings, a discharge from the unpaid deficit of his debts.¹

FEDERAL LAWS AND STATE LAWS

It is the object of the Federal Bankruptcy Law to protect an insolvent debtor's estate from seizure by any one or more creditors to the exclusion of other creditors and to prevent the insolvent debtor in the dis-

¹ Remington, *Business Man's Bankruptcy Manual*, p. 4.

tribution of his assets or payment of his debts from giving one creditor preference over another creditor.

On the statute books of most states, however, are state insolvency laws, varying somewhat from one another in details, which generally permit all forms of preferences, and lack provisions for protecting all creditors alike. Moreover, these state insolvency laws have no extra-territorial force, that is to say they do not operate fully beyond the territory of the state where the bankrupt maintains his residence. Then, too, many of the state laws make no provision for the discharge of an honest debtor, but leave him under the burden of his debts and the stain of insolvency. Fortunately these state laws are now held in abeyance by the Federal Act which was passed in 1898.¹

The United States Constitution gives Congress the power to enact uniform bankruptcy laws, and when Congress has once exercised this paramount jurisdiction all state insolvency laws are suspended in so far as they relate to the subject matter and affect the same persons as the Federal Bankruptcy Law. But the state laws are merely suspended, not repealed, and they would spring into existence again the moment the federal act was repealed. The chaotic conditions that would return if the act were repealed (and many unsuccessful efforts have been made to repeal it) are very clearly pictured in a booklet published by the National Association of Credit Men.

¹ Congress has enacted five different bankruptcy laws. That of 1800 was repealed in 1803. The law of 1841 was repealed in 1843 and that of 1867 in 1878, while the law of 1898 with amendments of 1903, 1906, 1910 and 1917 is still in force.

During those periods in our history when we have had no Bankruptcy Law, mutual confidences between debtors and creditors were impossible and likewise was impossible any co-operative action among creditors themselves. Insolvency always meant lawsuits. If one creditor had suspicion that a debtor was about to fail, immediately such creditor would rush to court and levy an attachment or execution. Then would begin a mad race for precedence between executions, attachments, etc.,—between the sheriff, receiver, assignee and mortgagee—to see which one would get possession of the debtor's property first, the receiver frequently finding upon arrival that he was forestalled by the sheriff under a levy or by some preferred mortgagee or assignee placed in possession by the debtor. In those days there was no possibility of co-operation among creditors, no incentive to a frank recital by a debtor to his creditors of the true condition of affairs, no chance for peaceable adjustment. Each creditor was eyeing the others, ready at a moment's notice to rush in ahead of them. It was the unmitigated reign of the "Survival of the Fittest."

Under the stern rule of the Bankruptcy Law, however, this wild scramble for precedence has ceased and co-operation among creditors has become the order of the day. This change was particularly manifest during the financial depression just passing.¹ Instead of creditors rushing to the courts, instead of debtors giving preferences, debtors and creditors alike have assembled in meetings, and there the debtor's books have been examined, his resources been inquired into, he and his creditors have consulted together; and in numberless cases, readjustments of his affairs have been ef-

¹ This reference is to the depression of 1907.

fectured upon a basis satisfactory to all, without court proceedings and with mutual good will.¹

For these reasons every credit man should actively co-operate in maintaining the Bankruptcy Law and in protecting it from the attacks that frequently are made against it.

RECEIVERSHIPS

Before a person may be thrown into bankruptcy he must be insolvent in the sense that his entire property at a fair valuation must be less than his liabilities, and further, he must commit one of the five acts of bankruptcy hereinafter described. A debtor may be insolvent in the sense that he is not able to meet his debts as they mature in the ordinary course of business, although at the same time he has total assets which greatly exceed his liabilities. All he lacks is sufficient cash, and if time is given him he may be able to convert sufficient of his assets into more liquid form and pay off all his debts. But impatient creditors may insist upon immediate payment, sue the debtor, obtain judgments and enforce them by selling the debtor's property at a judicial auction sale. At this sale the assets would not bring their fair value, and the amount realized would in all probability be insufficient to pay all creditors in full.

The property of the debtor, however, may be protected against such an invasion by the appointment of

¹ Remington, *Bankruptcy Law and Peaceable Settlements of Business Failures*, a booklet published by the National Association of Credit Men.

a receiver. Thus upon the application of creditors or of the debtor himself, and upon proof of the debtor's inability to meet his debts as they mature, a court of equity will usually appoint a receiver to sell the assets of the debtor gradually, at a fair valuation, and with the proceeds pay all creditors pro rata. In this way, the assets of the debtor may be conserved and the creditors insured equal protection. Frequently a deserving debtor becomes the victim of some sharp creditor who has no interest in the continued patronage of the debtor. For example, a business man may make some foolish investment that puts him under a heavy obligation, not to his mercantile creditors, but to a scheming promoter. The latter wants his money immediately. He has no interest in the effect a large withdrawal of funds may have on the business of his debtor. In such a case a receivership will usually result not in the liquidation of the business, but in its orderly continuance, until arrangements can be made to pay off the insurgent creditor without undue injury to the business. Sometimes when the creditors applying for a receiver learn of the true condition of the debtor at the hearing on the application, they will agree to an extension, and thus save the expense of a receivership.

Instead of seeking the appointment of a receiver, the creditors may ask for an injunction to restrain other creditors from impairing the value of the debtor's estate by suits and executions. If an injunction will sufficiently protect the rights of all creditors, the court may not appoint a receiver, but instead grant the much less expensive remedy of an injunction.

VOLUNTARY AND INVOLUNTARY BANKRUPTCY

When a debtor's assets at a fair valuation are less than his liabilities he may be thrown into bankruptcy. Or he, himself, may seek the protection of bankruptcy proceedings. Thus bankruptcy is of two kinds, voluntary and involuntary. The former is brought about by the filing of a petition by the debtor himself. When a debtor finds himself involved and prefers not to continue sustaining losses and is unwilling to give special advantages to some creditors, he may file a petition, accompanied by a list of assets and liabilities. The petition, the form of which is prescribed,¹ alleges that the petitioner "owes debts, which he is unable to pay in full; that he is willing to surrender all his properties for the benefit of his creditors, except such as is exempt from law," and expresses a desire "to obtain the benefits of the acts of Congress relating to bankruptcy."

In this manner he seeks, first, to have his assets equally distributed among all his creditors, and, second, to free himself of his debts, thus enabling him, unencumbered, to begin his business life anew.

Involuntary bankruptcy is effected by the filing of a petition² by creditors against an insolvent debtor, who has committed an act of bankruptcy, within four months after the commission of such act. This petition may be filed by three or more creditors who have provable claims aggregating at least five hundred dollars; or by one creditor having a claim for such an

¹ U. S. Supreme Court, Bankruptcy Forms, No. 1.

² U. S. Supreme Court Bankruptcy Forms, No. 2.

amount, provided all the creditors, excluding employees and near relatives, are less than twelve in number. The petition must allege these facts and state that the debtor owes at least a total of \$1,000.

Proceedings which are technically involuntary are sometimes practically voluntary. Thus a debtor acquaints several of his large creditors with his condition. His figures show that he cannot continue even if an extension were granted; it is quite clearly seen that the number of his creditors is so great that a common law settlement is quite out of the question. To protect the creditors' interests, they may advise the debtor to file a voluntary petition. But this debtor may have a special aversion to filing a voluntary petition, and so with his full knowledge and consent, his creditors file what is technically an involuntary petition. On the other hand, an involuntary petition may be filed by creditors who are not kindly disposed toward the debtor and who feel it is to their interest to take his business from him.

Now and then the filing of a petition is brought about by the acts of unscrupulous attorneys. Thus, a small debtor who finds himself insolvent may consult an unprincipled attorney whose first thought is neither of the debtor nor of the creditors, but only of himself and the prospects for large fees. Such an attorney obtains a list of creditors, not with the honest intention of arranging for a settlement, but merely to ascertain which of the creditors can be influenced to file a petition. These facts are then conveyed to a confederate, another attorney of the same despicable type, who procures the signatures of three tractable creditors to

a petition and nominally acts as their attorney. He then makes every effort to induce a majority of the creditors to permit him to be their representative in the meeting called to elect the trustee. If the confederate succeeds in electing his nominee he then procures an order authorizing him to act as the trustee's attorney. Now the whole situation is in hand, the case is all "sewed up." One scamp represents the debtor and the other represents the trustee; between them they control the subsequent handling of the estate.

The fees and expenses coming out of the assets of the estate are shared by the unscrupulous attorneys. But these collusive situations are susceptible to more serious abuses. It is hardly to be expected that an estate so controlled will be managed with a zeal for economy. Nor can it be expected that under the circumstances described the attorney for the creditors will expose and denounce the client of his accomplice if he discovers concealed assets, fraud, or material irregularities. An honorable debtor who falls into the clutches of such rascals suffers with his creditors, for no effort will be made, in good faith, to effect a settlement; the estate will yield these attorneys greater revenue than the poor small debtor can afford to pay and the fees are bigger if the case is carried through to final liquidation. The usual result is a very lean dividend for the creditors and a blackened record for the debtor.

Honest debtors can discharge their first obligation to their creditors by consulting reputable attorneys only. Creditors, on the other hand, should refuse to

give the representation of their claims to any attorney soliciting them unless they know him to be of unimpeachable integrity. Fortunately the vigilance of the legal profession and of the credit men's associations has succeeded in reducing the evils growing out of unprincipled practices by legal birds of prey.

WHO MAY BECOME BANKRUPTS

Voluntary bankruptcy is open to all individuals, firms and corporations, except banking, insurance, railway and municipal corporations. No special amount of indebtedness is required; a person owing one dollar or several millions may file a petition in voluntary bankruptcy.

Any insolvent person, except "wage earners" whose compensation is less than \$1,500 a year or "farmers" or "tillers of the soil," and any firm or corporation, except banking, insurance, railway and municipal corporations, owing \$1,000 or more and committing an act of bankruptcy may be put into involuntary bankruptcy.

FIVE ACTS OF BANKRUPTCY

As indicated above voluntary bankruptcy is begun by the filing of a petition by the debtor and need not be based on any act of bankruptcy. But before a court can adjudicate an insolvent debtor bankrupt without his own consent, and take charge of his property for the protection of all creditors, the debtor must commit an act of bankruptcy within four months of the filing of a petition by the creditors. The mere insolvency,

no matter how serious, of the debtor, does not give creditors the right to have him adjudicated a bankrupt. He first must have committed one of the following five acts of bankruptcy, having:

First. Conveyed, transferred, concealed, or removed, or permitted to be concealed or removed, any part of his property, with intent to hinder, delay, or defraud his creditors, or any of them; or

Second. Transferred, while insolvent, any portion of his property to one or more of his creditors with intent to prefer such creditors over his other creditors. The transfer must result in diminishing the insolvent estate. Thus the payment while insolvent of a pre-existing debt will suffice, but the payment of a debt which arose simultaneously with or after payment would not amount to a preference, as it does not diminish the insolvent estate. For example, the purchase of merchandise on "C.O.D." or "C.B.D." terms will not result in a preference, or diminution of the insolvent's estate, but merely in the substitution of one asset (merchandise) for another asset (cash).

Third. Suffered or permitted, while insolvent, any creditor to obtain a preference through legal proceedings, and not having at least five days before a sale or final disposition of any property affected by such preference, vacated or discharged such preference. This would result in depleting the insolvent's estate, to the benefit of one creditor and to the detriment of all others.

Fourth. Made a general assignment for the benefit of his creditors, or, being insolvent, applied for a receiver or trustee for his property, or, because of in-

solvency, a receiver or trustee having been put in charge of his property under the laws of a State, of a Territory, or of the United States, or

Fifth. Admitted in writing his inability to pay his debts and his willingness to be adjudged a bankrupt on that ground.

Until the debtor, while insolvent, commits one of these acts, the creditors may not place him in bankruptcy. Sometimes, in order to create one of these acts of bankruptcy, one creditor, with the approval of others who are anxious to have the debtor adjudicated bankrupt, will bring suit for a claim, obtain judgment and levy execution against the debtor's property. Thus the third act of bankruptcy will be committed and the creditors may then file their petition.

PROVISIONAL REMEDIES PENDING INVOLUNTARY ADJUDICATION

During the interim between the filing of the petition by creditors and the actual adjudication of bankruptcy, a dishonest debtor has ample opportunity to dispose of much of his property, either by selling it or by secreting it until after his discharge. But creditors are not without adequate protection during this interval. Upon sufficient evidence of the intent of the debtor to dispose of his property or to allow it to deteriorate, the creditors may avail themselves of one of several remedies. These provisional remedies may be enumerated as follows:

First. Upon filing an affidavit, showing the debtor's intent to dispose of his property, and a bond to pro-

tect the debtor in case the bankruptcy petition is dismissed, creditors may have the property of the debtor seized and held until the petition is adjudicated.

Second. Creditors may obtain an injunction restraining the debtor from disposing of his property. For disobedience of this injunction, the debtor may be imprisoned for contempt of court.

Third. Upon proving that the debtor is about to leave the jurisdiction of the court to escape the bankruptcy proceedings and examinations incident thereto, the creditors may apply for the arrest and detention of the debtor.

Fourth. Creditors may obtain the appointment of a receiver, when it appears that this is absolutely necessary for the preservation of the debtor's estate. Inasmuch as a receivership adds considerable expense to the administration of the estate, this remedy should be sought only when seizure or injunction appears to be inadequate. The remedy should be sought where the discontinuance of the business of a debtor would seriously depreciate the value of his assets as in the case of practically any large retail store. When necessary, the receiver may continue the business of the debtor until the election of a trustee by the creditors. For this reason it is important that the receiver be an efficient business man. The Court, in appointing the receiver, is pleased to consider names suggested by the creditors.

Fifth. In addition to the above, creditors may commence actions for the recovery of any assets the debtor may have fraudulently transferred. If, thereafter, the debtor is adjudicated bankrupt, the trustee will con-

tinue these actions for the benefit of all creditors, and if the goods are recovered the creditors who began the actions will be reimbursed for the expenses they sustained.

TRIAL

After the petition is filed, the debtor may appear and contend either that he is solvent, that he has committed no act of bankruptcy, that the court has no jurisdiction or that the allegations in regard to the probable claims of the petitioning creditors are untrue. In this event, the court hears the evidence on both sides and either dismisses the petition or signs a decree adjudicating the debtor a bankrupt. Or, as is more usual, the debtor may not appear and the court will sign the decree upon default.

REFERENCES

Upon signing the decree, the Court refers the case to a referee, who, acting as a court of bankruptcy, conducts all the usual future proceedings except the confirmation of a composition which may be proposed, and the final discharge of the bankrupt from further liability of his debts. These two matters must be passed on by the Court itself. Referees are appointed by the judges of each federal district for a term of two years. At least one referee is required for each county.

SCHEDULES

It is the duty of the bankrupt to file on prescribed forms a schedule of all of his property showing the amount, kind, location, and money value in detail, and also a list of all creditors, showing their residences, amount due each, the consideration thereof, the security held by them, if any, and a claim for such exemptions as he is entitled to. This schedule must be filed in voluntary proceedings at the time of filing the petition, in involuntary proceedings within ten days after adjudication.

MEETINGS OF CREDITORS

The referee is required to call a meeting of creditors of the bankrupt not less than ten nor more than thirty days after the decree of bankruptcy has been signed. Creditors are entitled to at least ten days' notice by mail of this meeting. Moreover, such notice must be published at least once, not later than one week prior to the date of meeting.

The referee or judge himself, if he so desires, presides over the meeting, and before proceeding with any other business, may allow or disallow the claims of creditors there presented, and may publicly examine the bankrupt or cause him to be examined at the instance of any creditor. At this first meeting the creditors also elect a trustee.

Subsequent meetings of creditors are held from time to time whenever the referee feels it is necessary to carry out the purposes of the bankruptcy proceedings.

A meeting must be called whenever one-fourth or more in number of those who have proven their claims file a written request to that effect. Moreover, a final meeting of creditors must be ordered whenever the affairs of the estate are ready to be closed.

The fact that creditors attend meetings does not indicate they control the proceedings. The Court merely seeks the advice of the creditors, but reserves the right to pass on any point in dispute between the creditors and the bankrupt or among the creditors themselves. The creditors, however, find that the right to be heard at meetings is a valuable one, as their suggestions as to the conduct of the estate are often adopted by the trustee. Moreover, the right of creditors to have the debtor examined is quite important, for extremely wide latitude is permitted in this examination. Not only may the bankrupt himself be examined, but also his wife, his assignee, his friends, and any one who might have the slightest information about any fraud committed by the bankrupt. These examinations frequently bring to light previously undiscovered assets of the bankrupt and enlarge the estate for the benefit of the creditors.

THE TRUSTEE

The most important right of creditors is the election of a trustee, whose duty it is to liquidate the assets of the bankrupt and distribute the proceeds to creditors as provided by law. The election is held at the first meeting of creditors. A majority vote, both in number of creditors and amount of claims, is necessary to elect.

The election of the trustee is subject to the approval

of the referee or judge, and in case of failure of creditors to elect a trustee, the referee or judge appoints one. The trustee elected by the majority in number and amount of creditors is practically always approved, and if the vote on the per dollar basis differs from that on the per capita basis, the choice of the majority in number of creditors is usually appointed.

The trustee, before entering upon his official duties, is required to file a bond, the amount of which is fixed by the vote of creditors at the first meeting. The trustee then takes title to all the bankrupt's property, except such for which exemption is claimed and allowed. As far as title to this property is concerned, the trustee practically stands "in the shoes" of the bankrupt. He holds the property subject to all legal and equitable liens. Thus the bankrupt's wife's right of dower is undisturbed. The seller's right of stoppage *in transitu* continues, and his right to rescind the sale and recover the goods for fraudulent misrepresentations of the bankrupt is unimpaired. The trustee acquires no better title to the property than the bankrupt had.

The trustee must also reduce all property to possession, liquidate it under the direction of the Court, as expeditiously as is compatible with the best interests of all parties concerned, and distribute the proceeds to creditors as required by law. He must keep account of all amounts received and disbursed, furnish information concerning the condition of the estate as requested by parties in interest, and make final reports and file final accounts fifteen days before the day fixed for the final meeting of creditors. This meeting, as

well as all others, should be attended by creditors. Above all, they should make it their duty to be present or properly represented at the first meeting to elect the trustee, for the election of a good business man familiar with the business of the bankrupt will insure the largest possible dividends.

PROOF AND ALLOWANCE OF CLAIMS

Before a creditor may participate in the election of a trustee or in the distribution of the assets of the bankrupt estate, he must file a proof of claim, and the claim must be allowed by the referee or court.

A claim is proved by filing a statement under oath, in writing, by a creditor setting forth the claim, the consideration therefor, and whether any, and, if so what, payments have been made thereon and that the sum claimed is justly owing from the bankrupt to the creditor.¹ The form of claim is prescribed, and the official blank may be obtained at a nominal cost from any legal stationer. Whenever a claim is founded upon an instrument of writing, such instrument, unless lost or destroyed, shall be filed with the claim. If the instrument is lost or destroyed, a statement of such fact and of the circumstances of such loss or destruction must be filed under oath with the claim.²

¹ Bankruptcy Act (1898), Sec. 57 a. U. S. Supreme Court Bankruptcy, G. O. No. 21, par. 1.

² Bankruptcy Act (1898), Sec. 57 b.

DEBTS WHICH MAY BE PROVED

Unliquidated claims for damages arising out of a tort, such as assault and battery, libel and slander, trespass and embezzlement, are not provable. But if the tort can be waived and recovery had on quasi-contract for unjust enrichment, or if the claim for tortious injury has been reduced to judgment before the adjudication, the claim may be proved.

No provision is found in the bankruptcy act permitting the proof of contingent claims. But where a person is contingently liable to pay the debt of a bankrupt his claim may be proved in the name of the creditor to whom he is liable, or if unknown, in his own name,¹ providing the creditor himself fails to prove the claim.

Claims for rent due or accrued at the time of filing the petition in bankruptcy are provable. But where at the time of adjudication, the bankrupt is lessee for a term of years, the rent being payable in installments, the landlord cannot prove a claim for rent which would accrue subsequent to the date of the petition unless the trustee elects to keep the leasehold as an asset. The trustee has a reasonable time to elect whether he will assume the lease. Even though he does not assume the lease, he may occupy the premises for a reasonable period, during which time the rent would be chargeable, not as rent under the lease, but as costs and expenses of administering the estate.

Unliquidated claims of a contractual nature, which might otherwise be provable, may be liquidated in a

¹ U. S. Supreme Court, Bankruptcy G. O. No. 21, Par. 4.

manner directed by the court and may then be proved and allowed against the estate. These include damages for breach of contract, but not claims for damages for torts which had not been reduced to judgment before the filing of the petition.

FILING PROOF OF CLAIMS

Claims cannot be proved against a bankrupt estate subsequent to one year from adjudication. The best practice for creditors to follow is to file their claims with the referee at or before the first meeting of creditors. In order to insure the receipt of the proof by the referee, registered post should be used in mailing a claim.

Filing proof of claim with the referee is sufficient to insure the creditor a pro rata share in the distribution of the bankrupt's estate and a vote at the election of the trustee. No advantage can ordinarily be gained by giving the claim to an attorney. Certain attorneys, offering to represent the creditor without any fee, make a practice of soliciting claims against an estate. Such attorneys should be avoided, for they can obtain for the creditor no more than can he himself. And eventually these attorneys are paid from some source. Perhaps by holding out in a composition settlement, they may obtain something additional for themselves from the debtor as an inducement (or bribe) to consent to the composition.

Where, however, a representative committee of creditors or an active adjustment bureau solicits the creditor's claim, he should file it with the referee, and,

under most circumstances, willingly give the committee or bureau a proxy to vote at meetings. He will usually find that this course insures the election of a more competent trustee and a more businesslike administration of the bankrupt's estate.

ALLOWABLE CLAIMS

Before a claim may be allowed by the court, it must be one which is provable, and it must be filed or proved in the proper form. However, some provable claims may not be allowed, or may not be allowed in full on account of errors, counterclaims, securities held, preferences or many other objections. Thus, secured claims are allowed only to the extent of the difference between the amount of the claim and the value of the bankrupt's property securing the claim. And, too, claims of creditors retaining voidable preferences are not allowed until the preference held is surrendered by the creditor.

VOIDABLE PREFERENCES

A debtor is deemed to have given a preference if, being insolvent, he has procured or permitted a judgment to be entered against himself in favor of any person, or made any transfer of his property, and the effect of the enforcement of the judgment or transfer will be to enable any one of his creditors to obtain a greater percentage of his debt than any other of such creditors of the same class. A preference is created regardless of the debtor's intent, provided that at the time of giving it the debtor was insolvent.

Under the Bankruptcy Act, a preference is voidable if (1) given within four months of the filing of the petition or after filing the petition and before the adjudication, (2) for a pre-existing debt and (3) if the person receiving it or benefiting thereby, or his agent acting therein, at the time of receiving the preference had reasonable cause to believe that the debtor intended thereby to give a preference. The trustee may avoid such a preference and recover the property or its value from the recipient for the benefit of the bankrupt estate. Moreover, the creditor receiving the preference must surrender the preference in order to participate in any further distribution of the debtor's estate.

But, if a creditor has been preferred, and afterwards, in good faith, gives the debtor further credit without security of any kind for property which becomes a part of the debtor's estate, the amount of such new credit remaining unpaid at the time of the adjudication in bankruptcy may be set off against the amount which would otherwise be recoverable from him.

PRIORITY OF PAYMENT OF DEBTS

Before any dividends may be paid to general creditors, the Bankruptcy Act provides for the payment in full of certain other debts. Thus, the debts of a bankrupt are paid by the trustee in the following order:

(1) All taxes legally due and owing by the bankrupt to the United States, state, county, district or municipality.

(2) The actual and necessary cost of preserving the estate subsequent to filing the petition:

(3) The filing fees paid by creditors in involuntary cases; and, where property of the bankrupt transferred or concealed by him, either before or after the filing of the petition, shall have been recovered for the benefit of the estate of the bankrupt by the efforts and at the expense of one or more creditors, the reasonable expenses of such recovery;

(4) The cost of administration, including the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one attorney's reasonable fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the petitioning creditors in involuntary cases, to the bankrupt in involuntary cases, while performing the duties herein prescribed, and to the bankrupt in voluntary cases, as the court may allow.

(5) Wages due to workmen, clerks, traveling or city salesmen, or servants of a bankrupt, which have been earned within three months before the date of the commencement of proceedings, not to exceed three hundred dollars to each claimant; and

(6) Debts owing to any person who by the laws of the States or the United States is entitled to priority.¹

DIVIDENDS IN BANKRUPTCY

Whatever remains after the above claims have been paid in full is distributed pro rata among all other creditors. The referee must declare dividends and prepare dividend sheets showing dividends declared

¹ Bankruptcy Act (1898), Sec. 64 b.

and to whom payable.¹ It is the duty of the trustee to pay the dividends within ten days after they are declared by the trustee.²

The first dividend must be declared within thirty days after the adjudication, if the money of the estate in excess of the amount necessary to pay the debts which have priority and such claims as have not been, but probably will be, allowed, equals five per centum or more of such allowed claims. Dividends subsequent to the first may be declared oftener and in smaller proportions if the judge so orders, provided, however, that the first dividend must not include more than fifty per centum of the money of the estate in excess of the amount necessary to pay the debts which have priority and such claims as probably will be allowed; and provided further, that the final dividend is not declared within three months after the first dividend is declared.³

COMPOSITIONS IN BANKRUPTCY

Instead of allowing the estate to be distributed in the above manner, the debtor may, either before or after adjudication, offer to settle with his creditors at a certain per cent of their claims, and, if the offer is accepted and approved, remove his estate from bankruptcy freed from all claims of creditors. This is known as a composition in bankruptcy. Before a composition will be approved by the court, the debtor must

¹ Bankruptcy Act (1898), Sec. 39 a.

² Bankruptcy Act (1898), Sec. 47 a.

³ Bankruptcy Act (1898), Sec. 65 b.

be examined in open court or at a meeting of his creditors and must file the list of creditors required to be filed by bankrupts.¹ The debtor's offer of composition before it can be approved by the court must be accepted in writing by a majority in number of all creditors whose claims have been allowed, which number must represent a majority in amount of such claims. Moreover, the consideration to be paid by the bankrupt to his creditors, and the money necessary to pay all debts which have priority, including the costs of the proceedings, must have been deposited in such place as the court designates.²

Thereafter the judge confirms the composition, providing he is satisfied that (1) it is for the best interests of the creditors, (2) the bankrupt has not been guilty of fraud such as concealing assets, (3) the bankrupt has not been previously discharged in voluntary bankruptcy within six years and (4) the composition is offered and accepted in good faith, and not made or procured by any means forbidden by the Act, such as secretly giving one creditor more than others. Even after the composition is confirmed by the court, it may be set aside at any time within six months thereafter on the ground of fraud.

During the hearing preceding the confirmation of a composition by the court, any creditor may oppose the composition by filing with the court written objections setting forth the grounds for opposing the composition. If the judge is satisfied that these grounds are adequate, even if the requisite number of creditors

¹ Bankruptcy Act (1898), Sec. 12 a.

² Bankruptcy Act, Sec. 12 b.

consent to the composition, he may refuse to approve the settlement. The estate would then be administered in bankruptcy as provided above.

When, however, the composition is confirmed, the Court appoints a distributing agent, usually the referee or trustee, who disburses the composition fund and makes a report to the court. The Court then dismisses the case and the debtor is discharged from all his debts, except those agreed to be paid by the terms of the composition and those not affected by a discharge.¹

DISCHARGE OF THE BANKRUPT

One of the objects of the bankruptcy laws, as was stated at the outset of this chapter, is to enable the creditors to take over the assets of an insolvent debtor and ratably distribute the assets among themselves, thus preventing preferences. How this is accomplished has been indicated above. The second object of the law is to release the debtor from his liabilities remaining unpaid after his assets have been taken by his creditors. This is accomplished through discharge in bankruptcy. Any person may, after the expiration of one month and within the next twelve months subsequent to being adjudged a bankrupt, file an application for a discharge in the court of bankruptcy in which the proceedings are pending; but if it appears to the judge that the bankrupt was unavoidably prevented from filing it within such time, it may be filed within, but not after, the expiration of the next six months.²

¹ See page 355, *post*.

² Bankruptcy Act (1898), Sec. 14 a.

The Court will then discharge the bankrupt from his liabilities (except those mentioned below) unless the bankrupt has committed one of the following acts expressly prohibited by the Bankruptcy Act: (1) Committed an offense punishable by imprisonment as provided by the Bankruptcy Act;¹

(2) With intent to conceal his financial condition, destroyed, concealed, or failed to keep books of account or records from which such condition might be ascertained; or

(3) Obtained money or property on credit upon a materially false statement in writing, made by him to any person or his representative for the purpose of obtaining credit from such person; or

(4) At any time subsequent to the first day of the four months immediately preceding the filing of the petition, transferred, removed, destroyed, or concealed,

¹ Sec. 29 b of the Bankruptcy Act (1898) provides:

A person shall be punished, by imprisonment for a period not to exceed two years, upon conviction of the offense of having knowingly and fraudulently (1) concealed while a bankrupt, or after his discharge, from his trustee any of the property belonging to his estate in bankruptcy; or (2) made a false oath or account in, or in relation to, any proceeding in bankruptcy; (3) presented under oath any false claim for proof against the estate of a bankrupt, or used any such claim in composition personally or by agent, proxy, or attorney, or as agent, proxy or attorney; or (4) received any material amount of property from a bankrupt after the filing of a petition, with intent to defeat this act; or (5) extorted or attempted to extort any money or property from any person as a consideration for acting or forbearing to act in bankruptcy proceedings.

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or permitted to be removed, destroyed or concealed, any of his property, with intent to hinder, delay, or defraud his creditors; or

(5) In voluntary proceedings been granted a discharge in bankruptcy within six years; or

(6) In the course of the proceedings in bankruptcy refused to obey any lawful order of, or to answer any material question approved by the court.¹

DEBTS NOT DISCHARGED

In general all provable debts, incurred before the petition was filed, are discharged by discharge in bankruptcy. The following debts, however, are not affected, but remain a claim against the bankrupt even after his discharge in bankruptcy.

(1) Taxes levied by the United States, the state, county, district, or municipality in which he resides;

(2) Liabilities for obtaining property by false pretenses or false representations, or wilful and malicious injuries to the person or property of another; or for alimony due or to become due, or for maintenance or support of wife or child, or for seduction of an unmarried female, or for breach of promise of marriage accompanied by seduction or for criminal conversation;

(3) Debts not duly scheduled in time for proof and allowance, with the name of the creditor if known to the bankrupt, unless such creditor had notice or actual knowledge of the proceedings in bankruptcy; or

(4) Debts created by his fraud, embezzlement, mis-

¹ Bankruptcy Act (1898), Sec. 14 b.

appropriation, or defalcation while acting as an officer or in any fiduciary capacity.¹

(5) Debts incurred after the petition has been filed.

If a creditor can classify his debt among any of the above groups he may proceed to enforce the collection of the debt as though no bankruptcy proceedings had taken place.

THE CREDIT MAN AND THE BANKRUPTCY ACT

Many factors have been at work attempting to have the Bankruptcy Act repealed. Those who would profit most by a return to the chaotic conditions which existed under the various state acts, and the resulting lack of co-operation among credit men, have been the most ardent advocates of the proposed repeal. Only through the retention of the Bankruptcy Act can the present highly developed system of free interchange of credit information and the resulting confidence among credit men continue. Moreover, the credit men should remember that under the Bankruptcy Act a much wider latitude is allowed in the examination of debtors who are suspected of fraud than in any other court or proceeding. Thus, through the searching examination of the debtor, his wife, and all others known to the debtor, which, under other proceedings might not be permitted, assets of fraudulent debtors are discovered and reclaimed for the creditors.

The Bankruptcy Act should be kept on the statute books. The procedure may from time to time be simplified so as to reduce the expense of, and to expedite,

¹ Bankruptcy Act (1898), Sec. 17 a.

bankruptcy administration. But this may be accomplished, as was demonstrated in past years, by suitable amendments to the Act. The abrogation of the Bankruptcy Act is wholly unnecessary to accomplish these ends. Its repeal would endanger the very life of our present credit system. Let every credit man not only passively acquiesce in the existence of the Act, but let him actively take part in defending and keeping the Bankruptcy Act in force.

CHAPTER XVIII

CREDIT SAFEGUARDS

GUARANTEES

One method of securing the payment of an account, where the credit of a prospective customer is limited or doubtful, is by having the customer procure the guarantee of some responsible party. Under the Statute of Frauds a promise to answer for the debt, default or miscarriage of another, to be binding must be in writing. A guaranty of another's account should comply with this provision.

Guarantees may be of several kinds. A general guarantee is one addressed to the public, while a special guaranty is for the benefit of only one creditor. The guarantee may be limited to a definite amount or it may be unlimited. It may further be for a definite length of time or may be continuous until revoked. Unless it appears to be the latter, it will be construed to be only for the present time.

When the contract of sale is entered into at the same time as or subsequent to the contract of guaranty, no special consideration is necessary to support the latter contract. Where, however, the contract of guaranty is made subsequent to the contract of sale, a new consideration moving from the creditor is necessary to make the guaranty binding.

Any special agreement altering the original terms of sale entered into by the debtor and creditor without the guarantor's consent will discharge the guarantor from all liability. Therefore, before granting any binding extension of time to a guaranteed account, a creditor should obtain the consent of the guarantor.

A useful form of guaranty is that recommended by the National Association of Credit Men. It will be noticed that it is a special, limited and continuous guaranty. The guarantor has the right to terminate the guaranty by giving written notice to the seller. This notice, however, will not affect the part of the guaranty already acted upon. A very valuable provision is that which permits a change in the original terms of sale between the vendor and the purchaser, so that an extension may be granted without impairing the guaranty.

FORM OF GUARANTY

The Undersigned, for and in consideration of one dollar (\$1.00) in hand paid by of hereinafter called the Purchaser, the receipt whereof is hereby acknowledged, and the further consideration of enabling the said Purchaser to buy goods, wares, and merchandise on credit of hereinafter called the Vendor, hereby jointly and severally, whether signed by more than one person or not, guarantee the payment of, and bind ourselves personally, our heirs, executors, and administrators to said Vendor, for the payment of all debts of every kind, name, and nature, including interest, which the said Purchaser is now owing, or may hereafter owe,

the said Vendor, whether due or not due, provided, however, that the liability of the undersigned hereunder shall not be for a greater amount than..... Dollars (\$.....) and interest.

The undersigned agree that the debts, payment of which is hereby guaranteed, may, by note or otherwise, be changed in form, extended, or renewed, at the option of said Vendor without notice to the undersigned, and the liability of the undersigned shall not be affected by such change, extension or renewal; that this guaranty shall remain in full force and effect up to such date as the said Vendor shall have received at its office in written notice from the undersigned to cease selling the said Purchaser on the strength of his guaranty; that the Vendor may at its option extend credit to the Purchaser to an amount in excess of the limit to this guaranty without impairing our joint and several liabilities hereunder; that should said Vendor commence suit against the Purchaser, or against the undersigned on this guaranty, to pay a reasonable attorney fee, and that the same may be taxed against the undersigned as part of the costs in said action.

The undersigned hereby waives notice from the Vendor of the amount of indebtedness, default in payment, or of the acceptance of this guaranty.

IN WITNESS WHEREOF, We have hereunto subscribed our names at..... day of..... A. D., 19....

Witness

.....
Witness

CREDIT INSURANCE

As we have previously pointed out, the credit man's objective is to reduce losses to a minimum without curtailing profits by unduly restricting sales. The credit man could, of course, eliminate substantially all losses by accepting only A 1 risks; but to do this would result in so serious a contraction of sales that the money saved by avoiding credit losses would be more than offset by the profits that would have been earned by following a somewhat more liberal credit policy. Therefore, to obtain a maximum of profits, the credit man keeps accounts which involve comparatively greater risk, with the result that some accounts turn out to be absolute losses. But when these risks are accepted, the creditor anticipates losses from some of them and provides against these expected losses by setting up a reserve. The amount to be added to protect or insure the creditor from this normal or expected loss is ascertained from the creditor's experience with his customers over a period of years. Thus the creditor *insures* himself against these normal or expected losses.

This, the distribution of the losses of the few among the many, is the fundamental principle of insurance. The aggregate losses, however, which any one creditor may add to his selling price, are necessarily limited by competition, and so it behooves each creditor to keep his losses to a minimum without unnecessarily injuring his sales.

DEFINITION OF CREDIT INSURANCE

Credit insurance, as devised by the existing credit insurance companies, does not comprehend the normal or expected loss above described. Credit insurance, or to use a more appropriate nomenclature suggested by another writer, "insurance to cover extraordinary losses in credits," protects the insured only against abnormal losses, that is, credit losses in excess of the so-called normal or expected loss incident to the particular business of the insured. The normal or expected loss, or, as it is frequently styled by the insurance companies, initial loss,¹ is usually expressed as a percentage of the gross sales of the insured, and must be borne by the insured, apparently on the theory that the company could not, for a premium charge smaller than this annual expected loss, insure against such loss each year.

ASCERTAINING THE INITIAL LOSS

There are two ways of fixing the initial loss, the forms of policies being constructed accordingly. Under one plan the initial loss may be determined at the beginning of the term of the policy, and made fixed and binding upon both the insured and the insurance company, for the purpose of calculating the abnormal loss at the expiration of the policy. In such a case, if sales for the past five years averaged \$1,000,000 and the losses during the same period averaged one-half of one per cent, the initial or "own" loss to be borne by

¹ On account of the fact that the insured must himself bear this initial loss, it is often referred to as his "own loss."

the insured is fixed at \$5,000, the company being liable only for such part of the insured losses as are in excess of the \$5,000 provided for in the policy.

Under a second plan the final determination of the normal or initial loss is left until the end of the term of the policy. In this case, the loss experience of the insured during the term of the policy is available as a factor in the determination of the proper initial loss. Thus, if a merchant doing a business of \$1,000,000 a year has a normal loss of one-half of one per cent during the five preceding years and during the life of the policy loses double the usual amount, the insurance company fixes six-tenths of one per cent of the annual sales as the initial loss to be borne by the insured.

DETERMINING THE INSURANCE PREMIUM

As in practically all forms of insurance, the insured must pay the insurance company a premium for the risk underwritten by the company. The premium or rate varies with the degree of risk incident to the business of the insured and is fixed by the insurance agent after a consideration of the following factors: (1) gross annual sales; (2) gross annual losses of the insured over a period of five or six years; (3) hazards of the business of the insured; (4) usual amount sold to any one customer; (5) customary terms of sale; (6) efficiency of the insured's credit department; (7) amount of insurance desired; (8) amount to be covered in any one account; (9) condition of accounts now outstanding on the books of the insured, and (10) the general business outlook. These facts are ascer-

tained by the company to enable it, by using good business sense and sound judgment, to formulate fair and reasonable premium rates and other terms.

Upon the expiration of the life of the policy it may be renewed or allowed to expire. In the former case, the experience of the previous year is a determining factor in fixing the renewal rates. Thus, if the insured sustains larger losses than usual, the initial loss figure will be increased accordingly.

LIMITATIONS OF THE POLICY

We have already pointed out that credit insurance, as the business is now conducted, compels the insured to assume an initial or "own" loss. Furthermore, credit insurance usually does not protect the insured against losses sustained on account of the failure of debtors who are not rated or who are poorly rated in Dun's or Bradstreet's. If, however, this class of debtors is covered by a special rider, the insured must, first, pay a very much larger premium, and, second, sustain at least a large part of such losses as may occur. Even where the debtor is well rated, the amount insured is limited to about 25% or 30% of the lowest capital rating given the debtor by Dun or Bradstreet. Moreover, the maximum provable loss on any one account is limited to some definite sum or to a definite percentage of the face amount of the policy. Any loss beyond these fixed limits is borne by the insured. Thus, if the insurance limit were \$500 on any one account, and the insured extended a credit of \$1,000 to a rated customer, only \$500 of the loss would be prov-

able under the policy; and if the debtor in question were "off rated" or possessed no rating, the insured could prove no loss under the policy.

A CONCRETE ILLUSTRATION

To illustrate concretely how credit insurance might work out in practice, let us assume a firm's average annual sales over a period of five years amount to \$1,000,000 and the average loss sustained for each of the same years is \$5,000, or one-half of one per cent. The firm takes out a policy for \$10,000, which allows a maximum loss on any one account of \$2,000. This amount, however, must not be in excess of twenty-five per cent of the lowest capital rating of the customer, who is rated in second grade credit standing or thirty per cent of the one rated in the first credit grade. A premium of \$500, i. e., 5%, is probably charged. At the end of the year the insured submits a list of his losses. Some of these are allowed, others not.

What is a loss is carefully defined by the terms of each policy. Not only are cases of actual bankruptcy provided for, but also cases where it is clearly evident that the debtor will be unable to pay. Under one form of policy the insured is required to make every practicable effort to collect the account or as much as possible. Whatever is collected is considered salvage and deducted from the allowed loss. Or the insured may turn the account over to the insurance company, in which case the entire amount of the account is considered loss, but the insurance company retains for itself whatever it can collect from the debtor by way of

settlement or through bankruptcy. Some policies make it compulsory for the insured to place in the hands of the insurance company all insolvent accounts covered by the policy on which he desires to prove losses. To this form of policy there has been raised the valid objection that the insurance company, when it receives such an account, will consider only its own interests to the exclusion of the interests of the insured. Take, for example, a case where a debtor is insolvent and offers to settle with his creditors at thirty-five cents on the dollar. Assume it is estimated that this account, by going through bankruptcy, will pay forty-five per cent. The considerations which will move a creditor to accept a settlement have already been discussed.¹ If he considered the debtor deserving, the creditor probably would prefer to accept the lesser sum. In reaching this decision he would be prompted either by consideration of past or the anticipation of renewed relations in the event the business were soundly rehabilitated. But would this interest of the creditor (the insured) prompt the insurance company to accept the settlement? Hardly! The insurance company is more apt to hold out for forty-five per cent, even to the extent of forcing the debtor into bankruptcy, for its only concern is the immediate settlement and not the business relations of the creditor (the insured) and the debtor.

TYPICAL ADJUSTMENTS

If the insured himself settles the account, he deducts the amount received from the allowed loss. At

¹ See page 316, *ante*.

Name of Customer	Rating (Dun)	Gross Loss	Allowed Loss (not to ex- ceed a specified max- imum, for example, not to exceed \$2,000 or 25% of lowest capital rating)	Salvage	Net Allowed Loss
A B Co.....	C 2	\$ 800	\$ 800	—	\$ 800
C D Co.....	D 2	1,900	1,900	\$ 300	1,600
E F Co.....	D 2	2,500	2,000	1,125	1,100
G H Co.....	G 3	2,000	1,250	800	750
I J Co.....	J 4	1,000	—	—	—
K L Co.....	E 2½	2,500	2,000	2,100	320
Various other losses..		3,000	2,000	600	1,600
Totals		\$13,700	\$9,950	\$4,925	\$6,170
Less initial loss borne by insured.....					5,000
Net amount paid by insurance company.....					\$1,170

the end of the policy year he submits a list of his losses, which may be as in the preceding table.

Thus, although the actual loss sustained by the insured is \$8,775 (\$13,700 less \$4,925) he is allowed to prove only \$6,170, the difference being accounted for by losses not allowed and by the method of deducting salvage. It will be noticed, for example, the gross loss in the E. F. Co. was \$2,500, the salvage \$1,125, leaving an actual net loss of \$1,375. But under this policy the maximum allowed loss is \$2,000, and a share of the salvage equal to the ratio of the allowed loss to

	2,000
gross loss is deducted from the \$2,000, i. e.,	—
	2,500
of \$1,125 = \$900, which deducted from \$2,000 leaves	
a net allowed loss of \$1,100.	

Then, in the case of the G. H. Co. only \$1,250 was allowed because its lowest rating (G 3) was \$5,000 and 25% of that amount is only \$1,250. From this allowed loss is deducted a proportionate share of the

	1,250
salvage, i. e.,	—
	2,000
of \$800, or \$500, leaving a net	
allowed loss of \$750. In the case of the I. J. Co., none	
of the loss was allowed, because the rating of J 4 was	
too low.	

It is interesting to note also that in determining the initial loss the insurance company computes all losses, including those that would not be allowable under the policy. For example, the initial loss of \$5,000 undoubtedly included many losses of the character of the I. J. Co., whose rating is so poor as to exclude it from

allowable claims under the policy. In practice, the losses on such companies make up a very large, if not a major part of the losses. If, then, these losses amounted to \$2,000 of the \$5,000 initial loss of the insured, he would have to sustain actual losses of \$7,000 before the insurance company would have any liability. This is obviously unfair to the insured. If "off rated" losses are not allowable under the policy, they should not be considered in computing the initial loss to be borne by the insured. The insurance companies should at least clearly explain these points to every prospective policy holder.

In the example given above, we may assume there are no "various other losses." Then the actual loss of the insured would be \$6,375 (\$10,700 gross loss less \$4,325 salvage), while the net allowed loss would be \$4,570, from which the \$5,000 "own" loss would be deducted, leaving the insured no claim against the company. On the other hand, we may assume that the losses are increased by several thousand dollars, and the net allowed loss amounts to \$19,000. We deduct the \$5,000 initial loss and the company is apparently liable for \$14,000. But the policy is for only \$10,000, and the insured can hold the company liable only for that amount.

ARGUMENTS IN FAVOR OF CREDIT INSURANCE

The advocates of credit insurance argue that it possesses many distinct advantages to the insured, and in addition stimulates trade and helps to prevent panics. Foremost among its advantages to the insured, credit

insurance, it is claimed, enables a merchant to tell in advance what his losses will be (apparently the "own" loss plus the insurance premium) and thus enable him to figure his costs accordingly. And, being secure from abnormal losses, the merchant can figure his profits with a reasonable degree of certainty. Obviously this is untrue. The insured does *not know* what his losses will be! Even though the insured in extending credits should be governed blindly by the ratings prescribed in the insurance policy, there is no absolute assurance that his losses will not be more than the face of the policy, and, as we have seen, the insured himself must bear all losses in excess of that amount. But certainly not even the most ardent advocate of credit insurance would suggest that a credit man should stupidly follow the ratings and disregard all other sources of credit information.

A merchant, for instance, may have no rating, but other sources of information may show him to be entirely worthy of a line of credit. Should the credit man in such a case keep his insurance policy before his eyes and turn down this account? No sane man would. But surely among the numerous cases of this kind, there will occur some losses. And these losses are not covered by the credit insurance policy. To that extent, at least, the insured cannot feel secure from abnormal losses, nor can he accurately foretell what his losses will aggregate.

In the second place, it is urged that to remove the peril of credit losses to a merchant makes for stability in credit. To quote a leading advocate of credit insurance, "What merchant, upon the first approach of

a flurry, becomes excited over his outstandings and plays a part in trouble making? Not the one possessing Credit Indemnity." The unsoundness of this argument is quite apparent. The premise that the "peril of credit losses is removed" is, as we have demonstrated above, untrue, and the argument must fail. Possibly, the insured has a greater degree of confidence in the security of his accounts covered by the insurance policy, and he is not as inclined to press those accounts too strongly for payment, thus precipitate their downfall and thereby further a general panicky condition. But, if this is so, is there not just as strong an incentive to become careless in collecting these accounts and thus invite losses. Or will the credit man remember that his insurance premium next year will be higher if his losses this year are large? And will not the credit man strive to keep his losses down below the initial loss, and thus twice profit, first from the losses saved, and second from the reduction in the initial loss the following year. Truly, credit insurance can have but little effect upon the honest and able credit man's treatment of his accounts.

THE "OWN" LOSS THEORY UNTENABLE

The question has been properly raised, "But why this own loss at all, if credits can be insured? Reasons have been advanced to justify it—some plausible, others fanciful. It is urged that as a man always expects to have a certain percentage of losses, he provides against them by adding a percentage to the selling price of goods, and his customers thus reimburse

him for the loss; that what he loses above this figure is abnormal and unprovided-for loss. If a merchant's customers reimburse him for his average loss, then in effect he has no loss at all, and his bad debts are simply debited against his merchandise account. Assume that he has an unexpected loss during a year, raising his losses from one-half of one per cent to one per cent, why can he not add an increased percentage to the selling price of his goods? What simpler system of insurance? If it is scientific to add the percentage of his average or 'own' loss to the selling price of goods, it would be equally scientific to increase the rate. 'Ah! but,' some one says, 'he knows what the average loss is, but he does not know what the abnormal will be. The average, if it be a correct average, must comprehend the abnormal, and can be computed from year to year.'

"It may be asserted in answer to this, that where goods are sold upon a close margin it would not be possible to add anything to the selling price over a very moderate or normal percentage, to cover losses from bad debts, without unduly increasing the price, and thus inviting inability to make sales. If the addition of a percentage sufficient to cover such losses is not feasible, then the 'own' loss theory is a fallacious one. Take the case cited where losses had been increased from one-half of one per cent to one per cent; a concern is carrying credit insurance as practiced and has been assuming an 'own' loss of one-half of one per cent; it charges this to the selling price of goods; the following year, however, its losses are one per cent. The policy of the credit-insurance company will be to increase the 'own' loss and, unless the merchant sub-

mits to the increase, to decline to write a new policy. Assuming that the merchant surrenders, how is he going to dispose of his increased 'own' loss? He must add it to the selling price of goods. . . .

"If a system can be devised which will insure credits within reasonable limitations, then it will not be necessary to add to the selling price of goods the percentage or ratio of failed accounts included in the 'own' loss class, and the cost of goods to consumers will be reduced to that extent. Even assuming that there is never any necessity for increasing the 'own' loss percentage in computing the price of goods, there is an item which must be added to the selling price, and that is the cost of the credit insurance. This cost is a legitimate expense, if it be proper to carry credit insurance at all. When these two items, 'own' loss and 'cost of credit insurance,' are considered together, as they should be, the question immediately arises as to the business wisdom of the outlay, this depending entirely upon the economic utility of credit insurance, its scientific operation, and its adaptability to the special line of business."¹

SHALL WE INSURE?

Credit insurance, as it is at present conducted, protects the insured to a limited degree against certain unexpected credit losses. Whether or not we should insure under this system depends largely upon the answer to the following question: Can we obtain a comparatively equal degree of protection in any other manner with a considerably smaller expenditure?

¹ Prendergast, *Credit and Its Uses*, pp. 327, 328, 330.

Credit insurance in the long run necessarily adds to the expense of a business more than the losses paid by the insurance company. In the aggregate the insurance companies receive premiums amounting to probably more than twice the losses paid. This obviously must be so, for the expenses of the insurance company in soliciting and conducting business are very high. While in any one year the aggregate losses paid may exceed the premiums received, this is more than offset by the experience of subsequent years, for the initial loss of the insured increases automatically. This is also true in the experience of any one insured merchant. If the loss he proves one year exceeds the premium paid, the "own" loss is increased and the insurance company charges a larger premium in ensuing years.

The above facts demonstrate that it is cheaper for a merchant to carry his own credit insurance, by setting up a reserve to take care of unexpected losses. But is it wiser for him to do so? The practice of many successful business houses as far as their fire insurance is concerned (and credit insurance is claimed to be analogous to fire insurance) has been to carry the hazard themselves when the risks are sufficiently scattered and the loss in any one risk cannot be too severe. Thus a concern with a thousand small buildings in different parts of the country might well carry its own fire insurance. And so, many of the large steamship companies have found it very much more profitable to carry their own insurance, for their ships are widely scattered. Then would it not be equally good business practice for a concern having a thousand scattered

debtors to carry its own credit insurance and save an amount equal to the salaries of solicitors, agents, and officers of credit insurance companies, which the insured in the end must pay.

In the average business firm the credit risk is sufficiently distributed to justify a policy of setting up a bad debt reserve, instead of taking out credit insurance. But where a firm sells only a few accounts, it might be otherwise. Although if the number of accounts were very few, the merchant would probably find the cost of credit insurance prohibitive. Probably the best course for him is to select his debtors with the utmost care so as practically to eliminate all risk of loss, and to set up a comparatively large reserve for unexpected losses.

"But," suggests the advocate of credit insurance, "suppose a country-wide panic plunged so many debtors into bankruptcy that the merchant's reserve becomes insufficient to take care of all the losses. What then!" As an answer it is suggested that if the losses were so severe it is a question whether any credit insurance company is now strong enough to stand the strain at all. Moreover, in such a case, the insured would find his policy was not large enough.

THE BEST CREDIT INSURANCE

From a careful consideration of the foregoing, we are forced to the conclusion that the practical course to pursue is the adoption of measures and the observance of principles which will minimize credit losses. The well-informed, clear-sighted credit man adopts proper

measures and follows correct principles. He, then, is the best credit insurance any business can have!

THE NATIONAL ASSOCIATION OF CREDIT MEN

The National Association of Credit Men was formed in 1896 with a membership of 600. To-day (1917) over 20,000 of the largest bankers and merchants in the United States are members. These bankers and business houses, united, are a powerful factor to protect and develop sound credits. To secure these ends, the activity of the Association is not confined to any narrow field. On the contrary, the Association is engaged in a very broad scope of constructive work. For instance, the Association is earnestly endeavoring to have enacted certain commercial laws for the protection of credits. Among these are laws to regulate the sale of stocks of goods in bulk, to penalize the giving of false statements, to regulate the doing of business under fictitious names, to regulate collection agencies, to punish fake advertising, etc. Not only is the Association interested in having the laws enacted, but it, and the local branches in the larger cities, see to it that the laws are enforced. A Legislative Committee of the Association devotes its attention to the enactment of the laws, while an Investigation and Prosecution Committee supervises efforts to prosecute offenders and fraudulent debtors.

This work is especially important, for the individual creditor has been disinclined to undertake the prosecution of fraudulent debtors on account of the expense

involved and time consumed. Now, however, the Association carries the burden, and its activity in this direction has been so great that crooked debtors are beginning to fear and appreciate the wrath and power of the Association. The result is that the individual creditor finds that he is better protected, and the entire credit structure is strengthened.

OTHER ACTIVITIES OF THE ASSOCIATION

In addition to the activities described, above the Association through its standing committees is actively engaged in

1. Improving the administration of the bankruptcy law.
2. Promoting reforms in the banking and currency system.
3. Making more efficient mercantile agency service, by co-operating with the commercial agencies.
4. Reducing the country's excessive fire waste and encouraging protection against loss by fire.
5. Popularizing the principle of commercial arbitration.
6. Arousing interest and activity in the prosecution of commercial fraud.
7. Developing effective credit department methods.
8. Encouraging credit education.
9. Aiding generally the elevation of business standards, principally through the dissemination of helpful business literature and through active educational work.

ADVANTAGES OF MEMBERSHIP TO THE INDIVIDUAL CREDIT MAN

The above activities of the Association result in substantial benefits to the entire business community, and necessarily are helpful to the individual creditor, whether or not he is a member of the Association. But, surely no creditor can be selfish enough to accept the benefits of other creditors' labors, unless he contributes something to bring about these beneficial results. This the individual creditor can best accomplish by joining the local branch of the National Association and by actively co-operating with it in accomplishing its worthy purposes.

In addition to these general benefits which all members derive, the individual creditor profits in numerous ways through his affiliation with the Association. For example, membership in the Association often opens the way to the interchange of ledger experience between members located in different parts. Inquiry forms, which have been described in the chapter on Sources of Information, bearing the imprint of the Association, are usually more effective than other means in gaining the information or results desired. Moreover, standard forms of financial statements may be obtained from the Association and used to advantage.

PUBLICATIONS OF THE ASSOCIATION

The individual member receives from the Association (1) A FIRST-OF-THE-MONTH LETTER containing brisk and brief items of information, advice and cau-

tion upon legal decisions, commercial statutes, and situations affecting the integrity of credits. (2) A MONTHLY BULLETIN, which is the only exclusive journal of credits published—a monthly compendium of credit activities, interesting papers and articles on credit or allied subjects and on the doings of the Association. One of the monthly bulletins gives in detail the proceedings of the convention of the Association, which is held in the summer of each year. The BULLETIN may well be described as the link between the credit grantor's desk and a nation-wide work. (3) Leaflets and pamphlets for the direct education of the retail merchant.

REPORTS ON COLLECTION AGENCIES

The individual member may also obtain from the Association a confidential report on any active collection agency or collection attorney with whom collection agreements are about to be made. This is an important and useful service to have at command, for there are many disreputable collection concerns pretending to make efficient collections.

ADJUSTMENT BUREAUS

In addition, the Association has thoroughly organized branches in over one hundred centers of manufacture and trade. There is scarcely a state without at least one branch. A majority of them have established efficient adjustment bureaus for the handling of insolvency claims, the administration of temporarily em-

barrassed concerns, and for investigations when extensions are asked. These bureaus, while conducted under affiliated branches of the Association, are accountable for their conduct to the National Association, which acts as a court of appeal in cases of grievance.

CREDIT EXCHANGE BUREAUS

A majority of the branches also conduct credit exchange bureaus, which are at the service of individual members, who, at moderate charge, will be supplied with reports on the actual experience of members with the subject of inquiry. Against dangerous credit extensions these bureaus have offered protection more definite and trustworthy than any other, and have also made possible safe and profitable credits which otherwise would have been denied.

In conclusion, then, considering the advantages of membership in the Association, every credit man should become actively affiliated with his local association and with the National Association of Credit Men.

CANONS OF COMMERCIAL ETHICS ADOPTED BY THE NATIONAL ASSOCIATION OF CREDIT MEN

I. "It is improper for a business man to participate with a lawyer in the doing of an act that would be improper and unprofessional for the lawyer to do.

II. "It undermines the integrity of business for business men to support lawyers who indulge in unprofessional practices. The lawyer who will do wrong things for ONE business man injures ALL business

men. He not only injures his profession, but he is a menace to the business community.

III. "To punish and expose the guilty is one thing; to help the unfortunate but innocent debtor to rise is another; but both duties are equally important, for both duties make for a higher moral standard of action on the part of business men.

IV. "In times of trouble the unfortunate business man has the right to appeal to his fellow business men for advice and assistance. Selfish interests must be subordinated in such a case, and all must co-operate to help. If the debtor's assets are to be administered, all creditors must join in co-operating. To fail in such a case is to fall below the best standards of commercial and association ethics.

V. "The pledged word upon which another relies is sacred among business gentlemen. The order for a bill of goods upon which the seller relies is the pledged word of a business man. No gentleman in business, without a reason that should be satisfactory to the seller, may cancel an order. He would not ask to be relieved of his obligation upon a note or check, and his contracts of purchase and sale should be equally binding. The technical defense that he has not bound himself in writing may avail him in the courts of law but not of business ethics.

VI. "Terms of sale as a part of a contract touching both net and discount maturity, are for buyer and seller alike binding and mutual, unless modified by previous or concurrent mutual agreement.

"No business gentleman may, in the performance of his contracts, seek small or petty advantage, or throw

the burden of a mistake in judgment upon another, but must keep his word as good as his bond, and when entering into a contract of sale faithfully observe the terms, and thus redeem the assumed promise.

VII. "It is always improper for one occupying a fiduciary position to make a secret personal profit therefrom. A member of a creditors' committee, for example, may not, without freely disclosing the fact, receive any compensation for his services, for such practices lead to secret preferences and tend to destroy the confidence of business men in each other. 'No man can serve two masters.'

VIII. "The stability of commerce and credits rests upon honorable methods and practices of business men in their relations with one another, and it is improper for one creditor to obtain or seek to obtain a preference over other creditors of equal standing from the estate of an insolvent debtor, for in so doing they take, or endeavor to take, more than their just proportion of the estate and therefore what properly belongs to others."

IX. "Co-operation is unity of action, though not necessarily unity of thought. When the administration of an insolvent estate is undertaken by the creditors through friendly instrumentalities, or when after critical investigation creditors representing a large majority of the indebtedness advise the acceptance of a composition as representing a fair and just distribution of a debtor's assets, it is unco-operative and commercially unethical for a creditor to refuse the friendly instrument or the composition arbitrarily and force thereby a form of administration that will be prejudicial and expensive to the interests of everyone concerned."

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